S. HRG. 100-585

ONE SHARE / ONE VOTE

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

WHETHER LEGISLATION SHOULD BE ADOPTED THAT WOULD PROHIBIT AN ISSUER FROM BEING LISTED ON A NATIONAL SECURITIES EXCHANGE UNLESS EACH SHARE OF ITS COMMON STOCK INCLUDES THE RIGHT TO CAST ONE VOTE

MARCH 17, 1988

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ONE SHARE/ONE VOTE

THURSDAY, MARCH 17, 1988

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:15 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Dixon, Sanford, Shelby, Graham, Wirth, Garn, Heinz, Armstrong, D'Amato, Hecht, and Chafee.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order. I apologize for being late. I had to be on the floor to make a statement so I just couldn't be here any earlier.

Today I am pleased to respond to requests from Senators Shelby and Armstrong to hold a hearing on whether legislation should be adopted that would prohibit a corporation from being listed on a national exchange unless each share of its common stock includes the right to cast one vote. Senators Shelby and Armstrong, I understand, are interested in building a record for the consideration of such an amendment when the committee's tender offer reform bill goes to the Senate floor. That bill was reported out of the committee by a vote of 14 to 6 late in September. In that markup the committee chose not to adopt a mandatory one share/one vote amendment and instead chose to have the SEC study the issue and submit its recommendations to the committee.

Let's face it, the idea of one share/one vote has a certain instant appeal to it because of its association with the just civil rights concept of one man/one vote. Being against the proposal is a little like saying you don't like apple pie or motherhood. But a little analysis suggests that the issue is not quite so simple and if pursued to its logical conclusion it could seriously weaken our economy.

Why is this? Simply because it would dramatically affect how an entrepreneur or a family founder of a business raises money to start an enterprise and how he or she keeps control of that enterprise once it goes public.

The proponents of one share/one vote are really arguing against States rights in this area and are advocating Federal preemption. They also argue shareholder ignorance on the part of those individuals who buy shares in companies such as Dow Jones, Ford, General Motors, Hershey, MCI, the New York Times, the Washington Post, McClatchey News, and thousands of less well-known companies.

We are told that just because these companies have dual classes of stock the individual shareholder is somehow disadvantaged. Is that argument credible? I don't think so. I have confidence in individual shareholders and believe they know exactly what they are doing when they invest in such companies.

It is the quick buck artists and the takeover entrepreneurs who seek change. They want to make it as easy as possible for companies to be put into play and taken over—and a Federal preemption, one share/one vote standard, would certainly further that cause.

I think it must also be recognized that dual listings may also serve many legitimate sophisticated needs of a company—witness GM's issuance of its class E and H stock.

Earlier this week I heard from Ray Shaw, the president of Dow Jones & Co., which owns the Wall Street Journal, on the subject of disparate voting rights. He wrote as follows:

> In Dow Jones' case, the creation of a new class of common stock was motivated by our stockholders' desire to insure the journalistic independence and integrity of the Wall Street Journal and the company's other publications and services into the next century. As a result, we firmly believe that Dow Jones' prospects for continued financial success will be improved to the substantial benefit of all our stockholders.
>
> Dow Jones' stockholders shared this view and expressed it in an overwhelmingly favorable vote; our minority shareholders alone voted 3-to-1 in favor. It strikes us as the opposite of stockholder democracy to declare this conclusion illegitimate.

Today we will hear from two outstanding panels of experts. There is considerable interest in this issue and I look forward to the testimony of our distinguished witnesses.

I have letters here from the New York Times and Dow Jones & Co., and I ask unanimous consent that they be placed in the record. I yield to my distinguished colleague, Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Time is brief and we have a large number of witnesses today, so I will simply ask unanimous consent that my statement be placed in the record.

STATEMENT OF SENATOR GARN

The subject of today's hearing is the one share-one vote concept which has long been established by the rules of the New York Stock Exchange. In 1984 the exchange imposed a moratorium on compliance with that rule pending further study. Since the moratorium was announced, 46 NYSE listed companies have issued voting stock with different voting rights, or have amended their charters to limit the voting power of certain groups of shareholders. More recently the NYSE proposed to permanently change its rules to permit different voting rights for classes of common stock, but only if certain safeguards were adhered to. The SEC has also issued a proposed regulation prohibiting the reduction of voting power of an outstanding class of common stock.

The questions raised by these developments are complex. On one hand, the concept of corporate democracy is long established in this country, and it is important to protect the rights of all shareholders. On the other hand, it is also important to permit corporations to structure their company in the way that best fits their corporate plans. Finally, we must also recognize the traditional role of the States with respect to corporate organization and voting power.

Congress should not tread lightly on this area of traditional State authority.

In light of these competing considerations, I am looking forward to hearing from today's witnesses, whose expertise in this area should be most enlightening.

The **Chairman**. Senator Sanford.

OPENING REMARKS OF SENATOR SANFORD

Senator **Sanford**. Thank you, Mr. Chairman.

I ask unanimous consent that my full statement be put in the record, but I would like to make a point or two in addition from it without going through the entire thing.

The **Chairman**. Without objection, so ordered.

Senator **Sanford**. I think the chairman has already pointed out that this is an appealing issue on its face, but it's also a tricky issue. One share/one vote just sounds like a good idea and indeed many have tried to compare it to our one man/one vote principle of government. But it's important that we don't fool ourselves because there's a tremendous difference here, and this is what's going to be spoken to and I will not dwell on that.

I think we make and point and made it before when this issue was discussed that whatever else we consider that it's firmly established that the States have the authority and have long had the authority to determine what corporate law is. The States control the corporations. The corporations are indeed instruments of State government.

The Supreme Court stated very clearly in the *CTS* decision—and incidentally, I've noted in here that a great many people are motivated it seems to me by a desire to overrule the Supreme Court *CTS* decision by this amendment—but in that decision, it said no principle of corporate law and practice is more firmly established than the States' authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.

And certainly, if we adopt legislation mandating voting rights, we destroy a tremendous part of that power of States to control their own corporations.

I think that it would be a great mistake for us to preempt State law by simply providing a Federal statute that would permit the Federal Government to decide that, and also I think, Mr. Chairman, that we should not preempt the rule making authority of the exchanges. It's been adequately handled at that level under the supervision of the SEC.

So I will not take any more time, but I'd like to add this to the record.

[Complete prepared statement of Senator Sanford follows:]

PREPARED STATEMENT OF SENATOR SANFORD

Mr. **Sanford**. Mr. Chairman, I thank you for responding to the requests of some on this committee to call for this hearing, and appreciate the fine testimony we have received from witnesses that will appear before us this morning.

The issue that is to be addressed this morning—whether the Congress should adopt national legislation that would prohibit corporations from being listed on a national securities exchange unless each share of its common stock includes the right to cast one vote—is a critical issue and an integral part of the debate over reforms to our takeover laws. I was pleased that when the committee voted to report out the bill on tender offer reforms, that it did so without a "one-share/one-vote" amendment. I would hope that we could avoid any such amendment on the floor of the Senate as well.

This is a tricky issue. One-share/one-vote sounds like a good idea, and indeed many have compared it to our one-man/one-vote principle of government. But I am concerned that we not fool ourselves. To my mind, Federal legislation mandating one-share/one-vote will have the effect of overturning the Supreme Court's decision in the *CTS* case and preempting our State laws. The Supreme Court stated very clearly in the *CTS* decision that "no principle of corporation law and practice is more firmly established that a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." I do not see how we adopt legislation mandating voting rights without completely violating that principle and calling into questions the basis for the *CTS* decision. I think that is a step we should be extremely reluctant to take.

In addition to my concern over preemption of State law and the upsetting of the careful balance between State and Federal law that the Supreme Court has established with the *CTS* decision, I believe that mandating one-share/one-vote violates the right of the shareholders to determine voting rights. After all, it is the shareholders, after full disclosure, who determine voting rights within their corporation. Neither the board of directors nor management can change these rights without shareholder approval. I do not see the justification in denying shareholders the right to determine their own capitalization plans and their own voting rights.

Moreover, as our second panel of witnesses so aptly states in their testimony, there are excellent reasons why disparate voting rights make a great deal of sense of many situations. To prohibit stock with disparate voting rights would preclude a number of innovative capital structures and financing of corporations that have proved to be very beneficial. Many corporations have adopted creative capital structures to accommodate complex acquisitions. In addition, as Mr. Coors and Mr. Hechinger so effectively state in their testimony, many of America's strongest corporations start out as family owned businesses that want to grow and sell equity, but in which the family wants and deserves to retain a certain measure of control. I simply don't see the need to outlaw a practice that has served our family run corporations so well.

Finally, Mr. Chairman, even if I thought the case had been made that dual-class voting rights were somehow damaging our equity markets, I still question the need for Federal legislation in this area. What those seeking this rule are trying to establish is the principle that stock cannot be traded on an exchange unless it carries a one-share/one-vote right. I would suggest that we not preempt those efforts nor preempt State law by simply rejecting a Federal statute mandating one-share/one-vote.

The CHAIRMAN. Thank you very much, Senator Sanford. Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I'd like to make a brief statement and it will be brief. At the outset, I'd like to say that I want to introduce in particular and to commend to the committee Bob Monks, who is known to many of us. Bob has served in government in a number of very important positions, most recently at the Department of Labor where he worked very hard on ERISA matters. He is currently president of Institutional Shareholder Services, and I must say that, while maybe I have not always agreed with everything that Bob has advocated—none of us ever will see eye-to-eye with any other human being, I suppose—he's one of the most thoughtful and compelling people I know.

With respect to the issue before the committee, Mr. Chairman, I commend you and the advocates of this hearing for calling it. I think it is quite easy to succumb to the political appeal the four words "one share/one vote" creates. We immediately think of corporate democracy and fairness for the little guy, accountability of management. Those are all very important concepts. And in the light of the treatment of the small investors during the October market crash, it's easy to jump on that kind of a bandwagon.

I would raise a flag of caution that proposals which require, in effect, a blanket one share/one vote go much further than in eliminating defensive recapitalization efforts by management. They would also, I fear, prohibit corporate practices and transactions that are not only useful and legitimate but also benefit the shareholders of the corporation and, therefore, I want to raise that red flag in one other connection, which is I'm troubled by the implication that such a requirement would have on a corporation's ability to raise capital.

I believe there may be some ways of getting at this issue to prevent the abuse of defensive recapitalization, but insofar as any kind of blanket approach would be concerned, I would have very, very serious questions.

Mr. Chairman, I thank you.

The CHAIRMAN. Senator Shelby.

OPENING REMARKS OF SENATOR SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Chairman, first, I would like to request permission to insert in the record a statement from Congressman John Dingell, my former chairman when I was in the House, who as chairman of the House Committee on Energy and Commerce, has on many occasions expressed his unequivocal support for a one share/one vote standard.

The CHAIRMAN. Without objection, that will be inserted in the record.

Senator SHELBY. Next, I request to insert in the record, Mr. Chairman, correspondence between myself and the Chairman of the SEC, Dave Ruder, concerning the status of the SEC's rule on shareholder voting rights and questions pertaining thereto.

The CHAIRMAN. Without objection, so ordered.

Senator SHELBY. Mr. Chairman, I'll try to be brief.

The Senate Banking Committee on September 30, as you well know, marked up and reported S. 1323, the Tender Offer Disclosure and Fairness Act. The committee adopted an amendment which required the SEC to conduct a study of the one share/one vote issue and its implications on shareholders' rights.

Everyone may be interested to know that Chairman Ruder in the aforementioned correspondence requested a modification in the study language adopted by the committee in order that the language would not provide an impediment to the SEC's final adoption of its proposed rule.

The committee has, until now, held no hearings on the issue of shareholder voting rights during the 100th Congress. I believe it's important that Congress develop its own record on this important issue.

Thus, Senator Armstrong and I requested, Mr. Chairman, that a hearing be held addressing this one share/one vote issue that you've acknowledged. I am grateful to you, Mr. Chairman, for this willingness to hold today's hearing and I ask unanimous consent that I be able to insert the rest of my opening statement in the record.

The CHAIRMAN. Without objection, so ordered.

[The complete prepared statement of Senator Shelby follows:]

STATEMENT OF THE HONORABLE RICHARD SHELBY
ON
SHAREHOLDER VOTING RIGHTS
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
U. S. SENATE

MARCH 17, 1988

MR. CHAIRMAN. FIRST I WOULD LIKE TO REQUEST PERMISSION TO INSERT IN THE RECORD A STATEMENT FROM CONGRESSMAN JOHN DINGELL, MY FORMER CHAIRMAN AND COLLEAGUE, WHO AS CHAIRMAN OF THE HOUSE COMMITTEE ON ENERGY AND COMMERCE, HAS ON MANY OCCASIONS EXPRESSED HIS UNEQUIVOCAL SUPPORT FOR A ONE SHARE, ONE VOTE STANDARD.

NEXT I REQUEST TO INSERT IN THE RECORD CORRESPONDENCE BETWEEN MYSELF AND THE CHAIRMAN OF THE SEC, DAVID RUDER, CONCERNING THE STATUS OF THE SEC'S RULE ON SHAREHOLDER VOTING RIGHTS AND QUESTIONS PERTAINING THERETO.

THE SENATE BANKING COMMITTEE ON SEPTEMBER 30, 1987 MARKED-UP AND REPORTED S. 1323, "THE TENDER OFFER DISCLOSURE AND FAIRNESS ACT". THE COMMITTEE ADOPTED AN AMENDMENT WHICH REQUIRED THE SEC TO CONDUCT A STUDY OF THE ONE SHARE, ONE VOTE ISSUE AND ITS IMPLICATIONS ON SHAREHOLDER RIGHTS. EVERYONE MAY BE INTERESTED TO KNOW THAT CHAIRMAN RUDER, IN THE AFOREMENTIONED CORRESPONDENCE, REQUESTED A MODIFICATION IN THE STUDY LANGUAGE ADOPTED BY THE COMMITTEE IN ORDER THAT THE LANGUAGE WOULD NOT PROVIDE AN IMPEDIMENT TO THE SEC'S FINAL ADOPTION OF ITS PROPOSED RULE. THE COMMITTEE HAS, UNTIL NOW, HELD NO HEARINGS ON THE ISSUE OF SHAREHOLDER VOTING RIGHTS DURING THE 100TH CONGRESS.

I BELIEVE IT IS IMPORTANT THAT THE CONGRESS DEVELOP ITS OWN RECORD ON THIS IMPORTANT ISSUE. THUS, SENATOR ARMSTRONG AND I REQUESTED THAT A HEARING BE HELD ADDRESSING THE ONE SHARE, ONE VOTE ISSUE. I AM GRATEFUL TO CHAIRMAN PROXMIRE FOR HIS WILLINGNESS TO HOLD TODAY'S HEARING.

Several significant events have occurred since the Committee met in September to draft a tender offer reform bill: the stock market plunged last October; the Delaware State Legislature in January adopted a very restrictive anti-takeover law; and the California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions endorsed federal preemption of state anti-takeover laws.

These events have changed the views of many concerning the federal government's role in regulating tender offers, especially with regard to the protection of shareholder rights. Today's hearing will address the proper and legitimate role of the federal government in protecting the rights of shareholders.

Corporate democracy requires a shareholder's right of ownership to be commensurate with his financial risk. The creation of dual class voting stock entails financial risk to the majority of a corporation's shareholders, but offers limited or no voting rights for most of those same shareholders. This violates the concept of corporate democracy and is harmful to investors. Moreover, one has to wonder what "publicly held corporation" will mean in the future if we continue to permit the proliferation of dual class common capitalization.

EACH SHAREHOLDER, BY VOTING HIS SHARES, COMPELS MANAGEMENT TO BE ACCOUNTABLE TO THE OWNERS FOR WHOM MANAGEMENT WORKS. THIS ACCOUNTABILITY HELPS PROTECT THE SHAREHOLDER'S INVESTMENT AND ACTS AS A CHECK ON THE POWER OF MANAGEMENT TO CONTROL THE COMPANY'S DIRECTION. WITHOUT A UNIFORM ONE SHARE, ONE VOTE STANDARD, SHAREHOLDERS LACK THE AUTHORITY TO MAKE MANAGEMENT ACCOUNTABLE.

THE FEDERAL GOVERNMENT HAS AN IMPORTANT INTEREST IN ADOPTION OF A UNIFORM, NATIONWIDE CAPITAL MARKET SYSTEM. INVESTORS BECOME CONFUSED WHEN INDIVIDUAL EXCHANGES HAVE DIFFERENT RULES AS TO THE VOTING POWER OF STOCK LISTED ON THEIR EXCHANGES.

IT IS IN THE INTEREST OF FAIRNESS AND CONSISTENCY THAT A NATIONAL CAPITAL MARKET SYSTEM HAVE A SINGLE STANDARD FOR SHAREHOLDER VOTING RIGHTS. THE INTEGRITY OF A NATIONAL CAPITAL MARKET DEMANDS THAT EACH SHARE TRADED BE A VOTING SHARE. A ONE SHARE, ONE VOTE STANDARD WAS THE NATIONAL STANDARD PRIOR TO THE NYSE'S RECENT ABANDONMENT OF IT. CONGRESS MUST ACT TO RE-INSTITUTE A NATIONAL VOTING RIGHTS STANDARD FOR NATIONAL EXCHANGES.

THOSE OPPOSED TO A UNIFORM ONE SHARE, ONE VOTE STANDARD CLAIM THAT IT WOULD PREEMPT STATE ANTI-TAKEOVER STATUTES, SUCH AS DELAWARE'S RECENTLY-ADOPTED BUSINESS COMBINATION STATUTE. THIS PREEMPTION ISSUE -- THE ROLE OF STATES VERSUS THE FEDERAL GOVERNMENT IN REGULATING ISSUES OF CORPORATE GOVERNANCE, INCLUDING TENDER OFFERS -- WILL BE DECIDED BY THE COURTS AS CORPORATIONS THEMSELVES CHALLENGE THE LEGALITY OF THE RESTRICTIVE PROVISIONS OF MANY OF THE ANTI-TAKEOVER LAWS. OUR ROLE, THE ROLE OF CONGRESS, IS TO SEE THAT A NATIONAL VOTING RIGHTS STANDARD IS CREATED AND IMPLEMENTED.

IN LIGHT OF OUR DIALOGUE ON THE ONE SHARE, ONE VOTE PROPOSAL IN THE MARK-UP ON S.1323 AND THE SEC'S RECORD ON THIS ISSUE, I BELIEVE THAT A ONE SHARE, ONE VOTE STANDARD SHOULD ALLOW FOR LIMITED EXCEPTIONS.

CLEARLY, THE STANDARD SHOULD GRANDFATHER COMPANIES WITH AN EXISTING DUAL CLASS CAPITAL STOCK STRUCTURE. ALSO, SOME CONSIDERATION SHOULD BE GIVEN TO EXEMPTING FAMILY-OWNED COMPANIES THAT DECIDE TO GO FORWARD WITH AN INITIAL PUBLIC OFFERING. CONGRESS IS CAPABLE OF DRAFTING A FAIR STANDARD WITH APPROPRIATE EXCEPTIONS. HOPEFULLY, TODAY'S HEARING WILL FOCUS ON THE PARAMETERS OF SOME OF THESE NEEDED EXCEPTIONS.

Today's hearing provides us with the opportunity to hear opposing views on a uniform one share, one vote standard. Hopefully, some common ground will result from this exchange of views. I look forward to hearing our distinguished panelists and hope they will offer suggestions as to what a uniform standard should entail.

Mr. Chairman, at this time I would like to request consent to insert in the record a statement from James E. Heard, the Executive Director of the United Shareholders Association, who is vitally interested in the one share, one vote concept.

Thank you, Mr. Chairman.

STATEMENT OF THE HONORABLE JOHN D. DINGELL
Chairman, Committee on Energy and Commerce
U. S. House of Representatives
On
Shareholder Voting Rights
Before the
Committee on Banking, Finance and Urban Affairs
U. S. Senate

March 17, 1988

I appreciate the opportunity to present my views on this important issue and I commend my colleagues in the Senate for holding this hearing.

Since 1926, the New York Stock Exchange has prohibited the listing of nonvoting or diminished voting common stock. In a January 3, 1985 press release, the NYSE announced that its Subcommittee on Shareholder Participation and Qualitative Listing Standards had issued a report to the Public Policy Committee of the NYSE Board of Directors, urging the Exchange "not to abandon its tradition of upholding shareholder participation in the affairs of corporations," but nonetheless recommending that listed corporations be permitted to create two classes of common with disproportionate voting rights--subject to the approval of shareholders holding two-thirds of the outstanding--whether or not affiliated with management.

As you know, I introduced legislation in the House in 1985 (H.R. 2783, the Shareholder Democracy Protection Act) designed to promote and preserve the concept of "one share, one vote." I did so in the belief that if two-class common were permitted by the New York Stock Exchange, and became widely used, a key market mechanism for corporate accountability would be removed. And, as a result, the exchanges would find themselves engaged in a "race to the bottom" as marketplaces competed for listings and trading volume.

Elimination of shareholder voting rights is not only unfair to common stockholders, but it is also an assault on a basic tenet of our economic system -- which is based on the broad public ownership of corporations. If this action occurs, it may have serious negative implications for the entire capital market system.

In that regard, Business Week stated in a July 8, 1985 editorial entitled "A Square Deal For Shareholders":

> The one-share, one-vote rule is a sensible extension of political equity to the stock exchanges. It assures corporate shareholders that their interests will not be outvoted by a small

> group holding far fewer shares that carry greater voting power. Special classes of stock can offer companies some advantages in raising capital, but the primary purpose of such stock is to create a defense against takeovers. And the defense undermines the rights of ordinary shareholders. Under the NYSE's proposed rule change, holders of as little as 5% of a company's equity could have 50% of the total vote. As a former Goldman, Sachs & Co. executive, John C. Whitehead, points out, sweeping aside the one-share, one-vote rule would lead many investors to believe that 'the cards are stacked against them.' Many investors already have that impression, and it makes no sense to confirm it.

The SEC has held hearings on this issue but to date has not put together a consensus on a voting rights rule. It was due to deep bipartisan concern for the protection of shareholders and uncertainty regarding the likelihood of appropriate action by the self-regulatory organizations or the SEC that the tender offer reform bills, H.R. 2172 and H.R. 2668, pending in the Commerce Committee, contain one share, one vote requirements. I introduced H.R. 2172 along with other Democrats on the Committee, while H.R. 2668 was introduced by several Republican Members.

It was not the intention of the sponsors of H.R. 2172 and H.R. 2668 to eliminate the traditional role states have played in the arena of corporate governance. Instead, it was our intention to provide, in the case of one share, one vote, minimum standards that corporations must meet if they are to be listed on the national exchanges. It was also our intention to put an end to abusive tactics such as greenmail which adversely affect the orderly operation of the nation's securities markets and which harm companies and their shareholders.

Both bills would help management defend itself against hostile takeovers by, among other things, closing the so-called 13(d) window, providing fines for so-called parking, extending the tender offer period, and outlawing street sweeps and open market purchases outside the coverage of the Williams Act. Both bills would restrict, in a very limited way, the ability of states to enact blatant anti-takeover laws that limit voting rights and violate certain minimum shareholder protection standards. As long as Congress continues to believe in our free enterprise system, in the ownership and voting rights of shareholders, and in the appropriateness of a federal system of tender offer regulation, such action is necessary.

Even some academics and economists traditionally associated with free-market theories have analyzed voting rights and found support for one share, one vote. For example, Frank H. Easterbrook and Daniel R. Fischel, in a June 1983 article, "Voting in Corporate Law," in the Journal of Law & Economics found conclusively that:

> The most basic statutory rule of voting is the same in every state. It is this: All common shares vote, all votes have the same weight, and no other participant in the venture votes, unless there is some express agreement to the contrary.
>
> Such agreements are exceedingly rare. Although there are hundreds of different voting arrangements, such as classified boards to which different shares elect to different posts, and preferred stock with contingent voting rights, almost all publicly traded shares in substantial firms have one vote each, and that vote may be cast for positions on an unclassified board. There have been persistent arguments that this is not 'democratic' because some people (those with more shares) have more votes than others.
>
> The presumptively equal voting right attached to shares is, however, a logical consequence of the function of voting we have discussed above. Voting flows with the residual interest in the firm, and unless each element of the residual interest carries an equal voting right, there will be a needless agency cost of management. Those with disproportionate voting power will not receive shares of the residual gains or losses from new endeavors and arrangements commensurate with their control; as a result they will not make optimal decisions.
>
> This also explains why there is so little nonvoting stock and is a justification for the New York Stock Exchange's policy of not listing firms with nonvoting issues. The greater the departure from equal weighting of votes among residual claimants, the greater the (unnecessary) agency costs.

John C. Whitehead, the former chief of Goldman Sachs & Co. warned in an excellent Fortune article, which I have attached to my statement, that "[i]f we treat [the public shareholder] badly, he will not be there when we need him." This admonition is particularly timely in the wake of the October stock market crash.

I appreciate your consideration of these views and look forward to working with you on this issue.

Attachment

BY JOHN WHITEHEAD

DON'T BEND THE BIG BOARD'S RULES

Allowing shares with unequal voting rights would drive investors out of the stock market.

John Whitehead *is a limited partner in and former co-chairman of the investment banking firm of Goldman Sachs & Co. He is also a former director of the New York Stock Exchange.*

■ It appears that the New York Stock Exchange is about to amend its rules to permit the listing of common stock that has only limited voting rights. The exchange is acting because several large companies, trying to guard against hostile takeovers, have recently created new classes of stock with limited voting rights, even though such action requires them to be delisted under current Big Board rules. The NYSE naturally wants to keep the listings rather than see the companies move to the American Stock Exchange or the over-the-counter market.

While at first glance this may not appear a major calamity, I believe that this action, if it occurs, will have serious negative implications for the whole capitalist system. There are 43 million individual stockholders in the U.S. The broad public ownership of our great American companies is one of the things that distinguishes our system from those of countries such as Germany and Japan and has made our capital market the deepest and most liquid in the world.

The one-share, one-vote principle has long been a cornerstone of this corporate democracy. If it is taken away or watered down, public investors will in time feel that the cards are stacked against them by some inside group that controls the votes, and they will no longer be willing to own their "share of American business," as the exchange's advertising slogan used to state. Furthermore, stockholder voting rights are an important reminder to management that it should always act in the stockholders' interest, a reminder that should not be given up lightly.

The NYSE has always been the champion of stockholder rights, and it will be a sorry day if the exchange begins to water down its principles to retain the listings of a handful of companies. Over the years, the exchange has required that listed companies conform to high standards of disclosure and conduct, including strict requirements for outside directors, independent audit committees, prompt dissemination of news, quarterly and annual reports to shareholders, and shareholder voting participation proportionate to equity interests. The exchange has always represented to the investing public that it will be treated fairly by dealing in securities listed there. Surely equal voting rights are an essential element of fairness. One wonders where the process will stop if the exchange indicates that listed companies can violate its rules with impunity.

A special committee of the exchange that considered this matter has recommended that the listing requirements be changed to permit limited voting stock provided that the voting differential per share is no more than 1 to 10. I believe this means that every listed company could issue a new class of stock that could have as little as 5% of the equity and yet have 50% of the vote. Put another way, the previously outstanding shares, representing 95% of the equity, would have less than a majority of the votes. Is this the corporate democracy for which the NYSE stands?

Part of the pressure for making this change comes from a legitimate fear on the part of corporate managements and directors of the abuses taking place in the takeover area. The unfriendly stockholder who purchases 5% or 10% of a company's shares, threatens a takeover with the objective of breaking up the company, and then accepts a greenmail bribe as the price of going away is certainly a less than admirable character on today's corporate scene. But to attempt to solve this problem by taking away stockholder voting rights is akin to burning down the toolshed to get rid of the beehive.

Perversely, the result of the committee's proposal is likely to be the opposite of what it assumes. If 5% of the equity now has 50% of the vote, the greenmailer's task is made easier, not harder. He can now buy control with a much smaller investment. He can afford to pay two or three times the market price for the heavy voting stock that represents control. The poor public stockholder, left with only his limited voting stock, will never receive any benefits from a takeover battle but will stand on the sidelines watching the price of the heavy voting stock rise to several times the price of his shares.

ANOTHER PROVISION of the special committee's report recommends that listing of limited voting shares be permitted only when their issuance has been approved by a two-thirds vote of all shareholders. The committee co-chairman, Andrew C. Sigler, chief executive of Champion International Corp., said in announcing the recommendations: "If two-thirds of the shareholders vote for something, who are we to impose our judgment that they're not right?" This certainly has an appealing commonsense ring to it. But what if two-thirds of a company's shareholders voted to disband the audit committee or discontinue the publication of quarterly and annual reports? I doubt that the exchange would permit continued listing of the company's stock. Standards of listing should be set by the exchange, not by a corporate vote.

Then there is the matter of protecting the minority. What about the one-third of the shareholders who, having bought their shares when they had one vote, find, after being on the losing end of a two-thirds vote, that their shares have only one-tenth of a vote? Do they not deserve more protection? I am not a legal scholar, but I doubt that our Constitution would permit a group of citizens, by a two-thirds vote, to turn over their political voting rights permanently to someone else. To me, the principle of corporate voting rights is similar.

Consider also the changing stockholder list. The stockholder who may have voted to give up his voting rights one day will very likely sell his stock to someone else the next day. I believe stockholder turnover in the average company is about 25% a year. So after a few years the limited voting stock is held by a whole new group of stockholders, none of whom voted to limit their voting rights. Does that seem fair for them?

Finally, there is the matter of family control. Take the case of a company that has gone public and is listed on the NYSE. The founding family still owns two-thirds of the stock, the public one-third. The company proposes that a new limited voting stock be issued pro rata to all shareholders. The proposal is supported by the family and passes, even if all the public shareholders vote against it. Now the family sells down to only 10% or so of the equity but keeps its heavy voting stock and keeps voting control of the company. Is that the intent of the exchange's proposal? Is that fair to the public stockholders? I conclude that the mere fact that a new class of limited voting shares has been approved by a two-thirds vote of the stockholders is not sufficient reason for the exchange to permit its listing.

If the NYSE lowers its standards, I fear that what has been called the race to the bottom will quickly occur, that all companies will move to whatever is the lowest common denominator the exchange will permit. I fear that underwriters that have resisted underwriting nonvoting and limited voting shares, including my own firm, will be unable to hold the line against competitive pressure. I fear that corporate democracy as we have known it will disappear.

I urge the exchange directors to consider not only whether this proposal benefits the exchange's competitive position and its listed companies, but also whether it benefits public stockholders. I urge the Securities and Exchange Commission to consider whether it is truly in the public interest to allow shareholder voting rights to be revoked. Ultimately, the SEC must approve changes in the exchange's rules. One possible alternative would be for the SEC to require that other markets upgrade their rules to be similar to the present rules of the NYSE.

The public shareholder is at the heart of the free-market system. If we treat him badly, he will not be there when we need him. ■

RICHARD SHELBY
ALABAMA

COMMITTEE ON ARMED SERVICES
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February 26, 1988

Honorable David Ruder
Chairman
Securities & Exchange Commission
450 5th St., N.W.
Washington, D.C. 20549

Dear Dean Ruder:

The Senate Banking Committee is scheduled to hold a hearing on the subject of a uniform voting rights standard for all issuers who do or would enjoy participation in our public markets. This hearing is tentatively set for March 17. Inasmuch as your predecessor testified on the subject before both Senate and House Committees during the 99th Congress, additional testimony before one of the same committees within a two year span would appear to be unnecessarily repetitive. However, in lieu of testimony, there are a few brief questions I wish to pose to you on the "one-share/one-vote" issue.

In June, 1987, the Commission issued a notice of proposed rulemaking concerning the potential adoption of a rule which would have the effect of amending the rules of the national securities exchanges and national securities associations regarding their listing and authorization requirements concerning shareholder voting rights. Public hearings were held with respect to the adoption of the rule. Since the public hearings, no apparent action has been taken by the Commission to make the proposed rule final. What is the status of the rulemaking procedure? Is it the intention of the Commission to adopt the proposed rule or a modified version? If not, why not? Is there a problem with the Commission's legal authority to promulgate the proposed rule? If so, does the Commission desire Congress to clarify its legal authority to issue such a rule? If this clarification is desired, a draft of the legislative language sought should be transmitted.

Answers to the above questions prior to the aforementioned hearings would be appreciated. If any additional information is needed, please do not hesitate to contact me.

Sincerely,

Richard Shelby

Richard Shelby

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FFICE OF
CHAIRMAN

March 15, 1988

The Honorable Richard Shelby
United States Senate
Washington, D.C. 20510

Re: Proposed Rule 19c-4

Dear Senator Shelby:

Thank you for your letter, dated February 26, 1988, concerning the status of the Commission's proposed Rule 19c-4 under the Securities Exchange Act of 1934 ("Act").

On June 22, 1987, the Commission published for comment proposed Rule 19c-4 concerning shareholder voting rights. Under the proposed rule, any company issuing stock or taking other action after May 15, 1987 that would have the effect of nullifying, restricting or disparately reducing the voting rights of existing shareholders would be prohibited from having its stock listed on a stock exchange or authorized for trading on an interdealer quotation system. On July 22, 1987, pursuant to the requirements under Section 19(c) of the Act, the Commission held public hearings on the proposal. To date, the Commission has received over 500 comment letters on proposed Rule 19c-4.

The October 1987 market break, related studies and Congressional hearings have delayed the Commission's consideration of proposed Rule 19c-4. At this time, however, the Commission staff is actively reviewing the numerous comment letters received regarding the proposal and preparing its final recommendations for the Commission's review. In light of this on-going review, I believe it would be premature to discuss what final action the Commission ultimately might take on this matter. Nevertheless, I can assure you that the Commission's review of proposed Rule 19c-4 and the voting rights issue remains a high priority on the Commission's agenda.

The Commission's legal authority to promulgate Rule 19c-4 ~~has been~~ questioned by a number of commentators and supported by others. As discussed in detail in the release proposing Rule 19c-4, the Commission believes that it has the authority under the Act to promulgate a voting rights listing standard that would apply to the self-regulatory organizations. We are, however, continuing to review comments in this area.

In this regard, I would note that one issue apparently has caused some confusion in this area. Specifically, Section 17 of the proposed Tender Offer Disclosure and Fairness Act of 1987, 1/ directs the Commission to review rules, policies, practices and interpretations of national securities exchanges and associations concerning shareholder voting rights and report to Congress the results of its review by October 1, 1988. Some commentators have suggested that, if enacted, such a requirement may suggest that before the Commission takes final action on proposed Rule 19c-4, the Commission should submit a separate study to Congress. 2/ We believe that the language of the proposed legislation in no way restricts the Commission to proceed, consistent with its statutory responsibilities, to consider adoption of Rule 19b-4. Nevertheless, it would be useful to clarify the scope of proposed Section 17. To this end, I have enclosed suggested language for the legislative history as requested.

I appreciate the opportunity to provide you with information on the Commission's current actions concerning the important issue of shareholders voting rights. If I can provide any additional information, please feel free to contact me or Richard Ketchum, Director, Division of Market Regulation, 272-3000.

Sincerely yours,

David S. Ruder

David S. Ruder
Chairman

Enclosure

1/ Report to Accompany S. 1323, S. Rep. No. 265, 100th Cong., 1st Sess. (1987).

2/ See enclosed Petition of the Business Roundtable to have the Commission conform its rulemaking on proposed Rule 19c-4 to Executive Orders 12612 and 12291, at 5.

Draft of Language for the Legislative History

The purpose of Section 17 is to direct the Securities and Exchange Commission to undertake a study of shareholder voting rights and report the results of that study to the Congress within the next six months. In directing the Commission to undertake such a study the Committee recognizes that the Commission has commenced a proceeding under Section 19(c) of the Securities Exchange Act of 1934 that is related to these issues. Nothing in the proposed amendment is intended to limit, delay, or otherwise restrict the Commission's existing authority to complete that proceeding during the pendency of the study. Indeed, the Committee expects that the Commission will promptly conclude those proceedings before the conclusion of the study and adopt those rules the Commission deems necessary or approriate to ensure investor protection and the maintenance of fair corporate suffrage under existing law.

January 15, 1988

Before the

Securities and Exchange Commission

Petition of the Business Roundtable to have the Commission Conform its Rulemaking on Proposed Rule 19c-4 to Executive Orders 12612 and 12291

File No. S7-22-87

Mr. Clifford L. Whitehill
Chairman of the Lawyers Steering Committee
of the Task Force on Corporate Responsibility
of the Business Roundtable

I. Introduction

The Securities and Exchange Commission ("Commission") is considering promulgating a regulation (proposed Rule 19c-4)[1] to prohibit the national securities exchanges and the National Association of Securities Dealers (NASD) from listing securities of companies which have taken actions that nullify, restrict or disparately reduce the voting rights of existing shareholders. The Business Roundtable testified at the public hearing on the proposed rule, held July 22, 1987,[2] and subsequently submitted formal written comments on August 5, 1987.

Previous comments by the Business Roundtable addressed questions relating to the Commission's authority to issue Rule 19c-4 and to the wisdom of the specific rule as proposed by the Commission, particularly the breadth of the rule and the Commission's substitution of its own judgment for that of corporate shareholders.

This petition, an extension of the previous comments of the Business Roundtable, does not address these issues nor does it address the merits of the rulemaking in a substantive way as in a conventional response to a request for comment. Rather, this petition is directed to the question of whether the

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[1] Voting Rights Listing Standards, Notice of Proposed Rulemaking at 52 Fed. Reg. 23665 (June 24, 1987).

[2] Testimony was given by Clifford L. Whitehill, Senior Vice President, General Counsel and Secretary of General Mills, Inc., appearing as Chairman of the Lawyers Steering Committee of the Task Force on Corporate Responsibility of the Business Roundtable.

Commission's instant proceeding should conform to substantive and procedural rulemaking requirements established by the Administration, in particular Executive Orders 12612, "Federalism", and 12291, "Federal Regulation". The Business Roundtable believes that conformity with these requirements can only benefit the Commission's instant proceeding and, accordingly, petitions the Commission to voluntarily comply with the two Executive Orders.

II. Executive Order 12612, "Federalism"

Executive Order 12612, "Federalism," issued October 28, 1987 (52 FR 41685, October 30, 1987), establishes principles and criteria to guide federal agencies on issues concerning the proper division of governmental responsibilities between the national government and the states. According to the Executive Order, the presumption of sovereignty should be with the state and against regulation at the national level, absent clear statutory authority. Where federal statutes do not explicitly preempt state law or reflect firm evidence that Congress intended preemptive federal regulation, agencies are to avoid preemption of state law by rulemaking. Any regulatory preemption of state law which is required by agencies is to be limited to the minimum necessary to achieve the statutory objectives.

The Federalism Executive Order requires that agencies determine which regulatory actions have sufficient federalism implications to warrant preparation of a Federalism Assessment. The Office of Management and Budget (OMB) is charged with ensuring government-wide compliance with the Order. All submissions to OMB for regulatory review under Executive Order 12291 are to address any substantial federalism concerns, as are rulemaking notices.

III. Executive Order 12291, "Federal Regulation"

Executive Order 12291, "Federal Regulation," was issued by the President February 17, 1981 (46 FR 13193, February 19, 1981). Its purposes are reducing the burdens imposed by existing and future regulations, increasing agency accountability for regulatory actions, providing Presidential oversight of the regulatory process, minimizing duplication and conflict of regulations, and assuring consistency with Administration policies, to the extent permitted by law. To achieve these objectives, Executive Order 12291 requires agencies to analyze the need for each regulation, the costs and benefits to society from the regulation, and alternative approaches to the objective sought. Proposed and final rules are submitted to the Director of the Office of Management and Budget (OMB) for his review prior to promulgation. Rules with annual effects on the economy of over $100 million must be accompanied by a formal Regulatory Impact Analysis (RIA).

IV. Application of Executive Orders 12612 and 12291 to the Commission

The substantive and procedural requirements of both Executive Orders, 12291 and 12612, are mandatory for federal agencies and Executive departments covered by 44 U.S.C. 3502(1). The Reagan Administration has chosen not to make compliance mandatory for the "independent agencies" specified in 44 U.S.C. 3502(10), including the Commission. Instead, the Administration has requested that these agencies comply with the Executive Orders voluntarily to the extent possible and permitted by law.

In a letter to the independent agencies dated March 25, 1981, Vice President Bush, as head of the Presidential Task Force on Regulatory Relief, articulated this request:

> "We appreciate that your organization's internal procedures may make it difficult for you to comply with every provision of Executive Order 12291. For upcoming major regulations, however, I am requesting that you voluntarily adhere to Sections 2 and 3 of the Order. To the extent you can comply with the spirit of the Order, this will help demonstrate to the American people the willingness of all components of the Federal government to respond to their concerns about unnecessary intrusion of government into their daily lives."

Sections 2 and 3, referred to above, set out all of the principles and procedural requirements of the Executive Order.

In a response to the Vice President dated April 9, 1981, then Commission Chairman-designate John Shad pledged to do his "level best" to implement Executive Order 12291, indicating that he had declared such intention at his confirmation hearing.

The Federalism Executive Order does not explicitly identify agencies as covered or exempted by that Order. Since implementation of the Federalism Executive Order is, by its terms, connected to regulatory review procedures of Executive Order 12291, the Administration's request that independent agencies comply with Executive Order 12291 would seem to apply to the Federalism Executive Order as well. The Administration has distributed the Federalism Executive Order to those agencies and apparently expects them to attempt to comply.

V. Relevance of Executive Orders 12291 and 12612 to the Commission's Proposed Voting Rights Listing Standards Rule

The Commission is considering the issuance of a new rule (No. 19c-4) which would require that self-regulatory organizations (SROs)[3] impose a one share-one vote standard for outstanding shares of stock of listed corporations. As the Commission is aware, the states, rather than the federal government, have historically regulated shareholder suffrage requirements and other corporate governance matters. The Commission's proposal would effectively preempt this state authority. The proposal is intended to prevent companies from using various hostile takeover defenses which reduce voting rights of shares acquired by hostile bidders. It therefore raises not only federalism concerns but also concerns regarding possible takeover abuses, particularly at this time when the depressed state of the dollar makes U.S. corporate assets very attractive to acquisition-minded foreign interests.

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[3] The New York Stock Exchange (NYSE), American Stock Exchange (Amex), Pacific Stock Exchange (PSE) and National Association of Securities Dealers Automated Quotation System (NASDAQ) would be covered by the rule.

We recognize that reasonable persons differ in their opinions concerning the potential impact of the Commission's rule and the legitimacy of the Commission's role in prescribing voting rights rules for the SROs. Because of these differing perspectives, we believe that the regulatory analyses associated with Executive Orders 12291 and 12612 are particularly appropriate as a means for carefully analyzing the issues.

The Commission's current rulemaking on Voting Rights Listing Standards raises a number of the questions to be addressed in the context of regulatory review under E.O. 12291, including the need for the regulation[4], its consequences, alternatives for achieving its objectives, consistency with Administration policy, timeliness[5], authority for the rule[6], and, most importantly, federalism implications.

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[4] See, e.g., Comments of the United States Department of Justice.

[5] Pending legislation, S. 1323 as passed by committee, would require the Commission to study one share-one vote and deliver a report to Congress by October 1, 1988.

[6] See, e.g., Comments of the American Bar Association.

The Voting Rights Listing Standards rulemaking clearly has "substantial federalism implications." As Justice Scalia recently pointed out, "[p]rescribing voting rights for the governance of state-chartered companies is a traditional state function with which the Federal Congress has never, to my knowledge, intentionally interfered." CTS Corp. v. Dynamics Corp. of America, 95 L Ed 2d 90 (April 21, 1987)(Scalia, J., concurring).

Commenters on the proposed rule have expressed concerns that it would have the effect of preempting state laws such as the Indiana control share statute upheld by the Court in CTS, in effect overturning that decision by rulemaking.[7] Since that statute eliminates voting rights of shares owned by an entity which acquires "control shares," corporations which fail to opt out of such laws could face delisting of their securities under the rule as proposed. Alternatively, the proposal could be interpreted as requiring delisting of companies at the time of the election required by the Indiana statute if the majority of disinterested shareholders do not affirmatively vote to grant voting rights to the control shares. No doubt, the Commission intends to clarify in its final rulemaking how the rule would apply to corporations in states with control share statutes. At the very least, however, a Commission rule along the lines proposed would deny states the option of allowing the corporations they charter to choose such voting plans at their own initiative. A state could provide control share voting limitations only by legislating them for its corporations across-the-board, albeit with mechanisms for opting-out.

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[7] See, e.g., Comments of the Business Roundtable, August 5, 1987; comments of Barnes and Thornburg, August 4, 1987.

VI. Recommendations of the Business Roundtable

The Business Roundtable believes that in its rulemaking on Voting Rights Listing Standards the Commission should conform to the Administration's request, set out in the Vice President's March 25, 1987 letter, that independent federal agencies comply with the substantive requirements of Executive Orders 12291 and 12612. Specifically, the Commission should prepare a Federalism Assessment in accordance with Executive Order 12612 and should also prepare a Regulatory Impact Analysis in accordance with Executive Order 12291. While we are not making any further procedural recommendations at this time, it seems clear that nothing prevents the Commission from requesting comment from the Office of Management and Budget on its proposed rule.

Statement of
James E. Heard
Executive Director
United Shareholders Association
to the
Senate Committee on Banking,
Housing and Urban Affairs

March 16, 1988

I appreciate the opportunity to present this statement in support of legislation to create a one share, one vote standard for all stocks traded on national markets and major exchanges.

The United Shareholders Association has been actively seeking a one share, one vote mandate since the organization was formed in August 1986. USA has twice testified at hearings of the Securities and Exchange Commission on the need for the commission to promulgate a rule protecting shareholders from unequal voting rights plans. We also have urged enactment of one share, one vote legislation in Congressional testimony on several occasions.

In addition to one share, one vote, we also support legislation to require confidential proxy voting, independent third party tabulation of voting results, and equal shareholder access to proxy materials. With these changes, the corporate voting process will be an effective system for management accountability to shareholders.

One share, one vote is a fundamental democratic principle intended to ensure accountability by the managers of America's public corporations to the shareholders who own the corporations. Underlying the principle is the fact that each share of common stock carries equal risk. Under a democratic system of corporate governance, shareholders should be entitled to a vote equal to the size of their ownership in the corporation.

This basic guarantee to shareholders has been abandoned by managers at nearly 300 companies, including 34 Fortune 500 firms and 52 corporations listed on the New York Stock Exchange. In adopting unequal voting rights plans, managers of these companies have found the ultimate entrenchment device. These plans permanently disenfranchise shareholders while granting control to a handful of insiders who often have small levels of actual ownership in the company. Once lost, voting rights will not be restored by entrenched management.

The result is executives who control the company without financial risk. Disenfranchised shareholders retain most of the ownership and risk, but are left with no voice in corporate affairs. When total control of the corporation lies with those who have little financial risk, accountability is lost. Managers are free of any shareholder scrutiny, no matter how poor their performance.

In large public corporations where ownership is often diffuse, exercise of the proxy vote is the only way for shareholders to express their ownership interests. As the owners of America's corporations, shareholders bear the ultimate risk for corporate success or failure. To protect their interests, shareholders elect a board of directors, which usually includes members who are drawn from top management as well as "independent" outsiders. When management controls the votes in a public corporation, however, even the independent directors serve only at the behest of the executives who appoint them. It is difficult to see how shareholder interests can be protected by a board that is elected without any pretense of accountability to shareholders. The problem of accountability is compounded by management's control of the proxy process.

Without a one share, one vote standard, power to direct the use of the nation's wealth and resources will rest in the hands of self-interested and self-perpetuating private bureaucracies. Shareholders will suffer immediate losses in the value of their stock. A study by the Securities and Exchange Commission's Office of the Chief Economist in July 1987 found "significant negative wealth effects" at the announcement of an unequal voting rights plan.

A new tactic of anti-shareholder management interests is to argue that federal standards on voting rights would be an intrusion on the ability of the states to regulate corporate governance. This is a purposeful misrepresentation of the facts and the history of the federal role in protecting shareholder voting rights. In fact, exchange listing requirements have come under federal regulation since the creation of the Securities and Exchange Commission in 1934.

The intent of Congress to protect the exercise of shareholder voting rights is clear from the legislative history of the Securities and Exchange Act of 1934. The report of the House Interstate and Foreign Commerce Committee said:

> Fair corporate suffrage is an important right that should attach to every security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies. Insiders having little or no substantial interest in the properties they manage have often retained their control without an adequate disclosure of their interest and without an adequate explanation of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purpose for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights. Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchange should involve a corresponding duty of according to shareholders fair suffrage. For this

> reason the proposed bill gives ... the commission power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders.

Seen in this context, a one share, one vote mandate is certainly consistent with a continuing federal effort to protect shareholder voting rights.

The New York Stock Exchange adopted its single class common stock rule in 1926 following a popular rebellion against large economic entities controlled by those with a small economic stake. Although the NYSE is not a federal agency, its rules form an integral part of the federal regulatory system. Any change in the exchange's listing standards must be approved by the SEC. Thus, the NYSE's one share, one vote rule has carried the full force of federal law for more than half a century.

There are those who say that one share, one vote needs to be studied before action can be taken. If there is another area of financial regulation which has received more evaluation in the recent past, I am unaware of it. The record is replete with analyses conducted by academics, economists, and legal experts. Further study is unnecessary.

The Securities and Exchange Commission has recently conducted an exhaustive study of the one share, one vote issue. At hearings in December 1986 and July 1987, the SEC heard from more than 50 witnesses. It also received more than 500 letters of comment. The overwhelming sentiment was in favor of preserving and expanding one share, one vote. Following the first set of hearings, the SEC instructed the major exchanges to attempt to reach an acceptable compromise to prevent unequal voting rights plans. When the exchanges failed, the SEC proposed a rule, 19c-4, intended to prevent shareholder disenfranchisement. The proposal is still pending.

Rule 19c-4 will stop some unequal voting rights schemes, but it is not a true one share, one vote standard. Shareholders need the basic protection afforded by a one share, one vote guarantee. By setting minimum standards for corporate voting rights, Congress will ensure that shareholders maintain a voice equal to their stake in the company. Despite laudable efforts by the SEC, Congressional action in favor of a uniform one share, one vote standard is needed.

Congress should also extend shareholder protections to other aspects of the corporate proxy voting process. A confidential vote, independent tabulation of ballots, and equal shareholder access to proxy materials are needed reforms that Congress should consider along with a one share, one vote standard.

This week's hearing is about fairness for America's shareholders. Congressional inaction will send the wrong message to managers, shareholders and the courts. It will say that Congress is abdicating half a century of protection of America's 47 million shareholders. It will say that shareholders have no voice in running the companies they own. This is not the message Congress sent when it passed legislation to protect individual shareholders in 1934, and it is not the message Congress should send today.

APPENDIX A

T. Boone Pickens, Jr.

General Partner

Mesa Limited Partnership

Testimony on the Proposed One Share, One Vote Rule

The Securities and Exchange Commission

July 22, 1987

2:00 p.m.

Good afternoon, Chairman Cox and Members of the Commission. My name is Boone Pickens, and I am General Partner of Mesa Limited Partnership and Chairman of the United Shareholders Association.

I started Mesa's predecessor company in 1956 with $2,500 in cash and a $100,000 line of credit. Mesa went public in 1964 and was listed on the New York Stock Exchange in 1969. Since then Mesa has listed four additional securities on the Exchange. Mesa has grown from a company with assets worth slightly less than $2 million in 1964 to a company today with assets of $3 billion. During that time, Mesa has faced many of the same challenges confronting America's start-up companies and its more established companies as well.

While building Mesa into the largest independent energy firm in America, I learned a lot about corporate America. These lessons prompted me last year to start the United Shareholders Association, a non-profit advocacy group dedicated to advancing the rights of over 47 million Americans who participate in the free enterprise system by owning stock and other securities.

I commend the Commission and its staff for their efforts over the past six months to create a universal one share, one vote standard for U.S. securities exchanges. I commend the Commission for its efforts to bring together the various securities exchanges to enact a meaningful standard. I especially applaud the Commission for its continuing efforts to stop management schemes that disenfranchise the owners of corporate America -- its shareholders -- and that reduce managers' accountability to these owners.

As you may recall, I testified against the New York Stock Exchange proposal before the Commission in December 1986, and at that time proposed the adoption of a universal one share, one vote standard. I continue to support a universal standard. I am here today to urge the Commission to resist pressure for exceptions that would make the standard meaningless. Shareholders have not asked for these exceptions, managers seeking to preserve their jobs and to preserve their perquisites have.

Just last week the Commission's Office of Chief Economist concluded that the adoption of unequal voting plans had a significant negative impact on share prices, substantially reducing shareholder wealth. This new evidence underscores the need to close the door to exceptions that undermine the rule.

We have supported the fundamental principle of one share, one vote not only in theory but also in practice. When Mesa went public in 1964, we did not even discuss, let alone consider, the possibility of adopting anything other than a one share, one vote capital structure. At the time we faced many of the same temptations that opponents of the one share, one vote standard confront today, such as raising capital while still maintaining control. In 1986, when Mesa Limited Partnership acquired the assets of Pioneer Corporation in exchange for 61 million newly-issued partnership units, Mesa gave these new units voting power equal to our existing units. Also in September 1986 when Mesa issued

29 million partnership units to raise equity capital, Mesa gave those new units voting power equal to that of existing units. Like many of the companies that have recently adopted a dual capital structure, Mesa and its existing shareholders could have protected their control of the company by giving these units less than one vote per share. But we felt strongly that for a company to remain healthy, the voting power of its common shareholders must be directly proportional to their financial risk.

In contrast, General Motors and a number of other large companies caused this crisis in shareholder democracy by pressuring the New York Stock Exchange in 1984 to abandon its traditional one share, one vote standard, a standard that the Exchange had maintained since 1926. This crisis has rapidly assumed epidemic proportions. The Investor Responsibility Research Center estimates that, as of January 1987, thirty New York Stock Exchange and eighty-nine American Stock Exchange-listed companies have adopted a dual capitalization structure with unequal voting rights, as have another ninety-two companies traded in the over-the-counter market.

Before commenting on the specific proposal set forth by the Commission, I would like to underscore the principal concern that should guide the Commission in its deliberations on this issue: restoring accountability. The issue of one share, one vote is of critical importance not only to each of the 47 million shareholders in America, but to the economic vitality of our nation. Anything less than a universal one share, one vote standard will result in some managers having irrevocable autonomy from the owners of corporate assets, and will make it virtually impossible for shareholders to discipline these managers, no matter how poor their performance. It will eliminate the accountability of managers to shareholders, who alone bear the financial risk for the actions of management. This accountability to owners is the foundation of our capitalist system. Widening the gap between ownership and control of corporate assets will hamper our corporate performance and decrease our competitiveness in global markets. We know what results from tenuring executives -- we are experiencing it today in record trade deficits, plant closings, and the elimination of jobs. Managers should be held accountable for their performance, past and present. This accountability -- through equal voting rights -- is the foundation of our system of corporate democracy. It provides the necessary incentive for maximizing productivity and profitability. As our economy takes on increasing global dimensions, it is now time to revitalize this incentive by reinforcing accountability, not by eliminating it.

The Commission's proposed rule represents a substantial step in the right direction. It sets the expectation of one vote for one share, except where the relevant exchange or association can establish, with the approval of the Commission, that unequal voting is warranted. Properly viewed, this should place a very heavy burden on the securities markets to justify an exception to this rule. Based on my experience at Mesa, however, I question whether even the current exceptions contemplated by the Commission in its rulemaking are desirable or necessary. As I stated previously, Mesa has always strictly adhered to the one share, one vote principle, despite having faced the very same situations -- initial public offering, acquisitions, and the need to raise additional capital through new offerings -- that the Commission contemplates exempting from the one share, one vote mandate. My concern is that these exemptions may raise unforeseen problems. For instance, although a purchaser of stock in an initial public offering may know that the stock has less than one vote per share, a purchaser of that stock on the secondary market is much less likely to know this. Similar problems might arise with stock exempted under the other two exceptions. The Commission must contemplate problems like this before it sanctions any such exceptions.

Although I have certain concerns about the exceptions contemplated by the Commission to the one share, one vote mandate, I am pleased to see in the Commission's Release that it "has not identified other specific instances where there is a bona fide business purpose for the issuance of disparate voting rights securities." This rule should be strictly construed so as to minimize shareholder disenfranchisement wherever possible. I would also hope that the Commission will be particularly mindful of the need for managers to be held accountable to shareholders for their performance -- a principle that the Commission has focused on in its rulemaking release -- when the securities exchanges propose additional exceptions to the one share, one vote mandate. Competition between the exchanges should not be an acceptable basis for additional exceptions.

Proponents of a universal one share, one vote rule, including Mesa and the United Shareholders Association, have fought a long battle over the past two years against corporate bureaucrats who have turned to the securities exchanges and the Commission for protection from competition in the marketplace. Influential members of Congress, like Congressmen Dingell, Markey, Rinaldo, and Lent, also propose mandating a universal one share, one vote standard. Although we would prefer that the exchanges themselves get their houses in order, we have enthusiastically supported these legislative initiatives.

I especially support the formulation in Chairman Dingell's proposed bill that makes it illegal for broker-dealers to trade securities that do not comply with one share, one vote. One vote per share should be the rule, not the exception, and Chairman Dingell's proposed legislation states that mandate concisely and effectively. That formulation also has the very considerable benefit of preempting state anti-takeover statutes, like Indiana's Control Share Acquisition Act, that interfere with shareholders' fundamental right to vote their shares. Statutes such as these would have the effect of fragmenting, under state law, what should be a unified system of regulation. In an era when all of our markets, especially our capital markets, are becoming increasingly international in scope and subject to challenge from large foreign competitors, there is an even greater need for uniformity of regulation of the takeover process through federal law.

I am also concerned about "grandfathering" the unequal voting provisions that have been put into effect to date in over 200 American companies. From a strictly theoretical perspective, it may make little sense to correct an abuse in the future, as the Commission does with its one share, one vote rule, but at the same time permit widespread abuse in the past to go uncorrected. Although these recapitalizations may have been subjected to shareholder vote, in many of these instances shareholders were enticed through questionable means (such as "dividend sweeteners" or pressure applied on corporate pension plan managers) not to vote against the proposed corporate recapitalization. I recognize, however, as a practical matter such a "grandfather" provision might be necessary.

The "grandfathering" provision does highlight a related issue that I believe is of crucial importance to shareholder democracy -- the shortcomings of the existing proxy process. In a matter where the central issue is the allocation of corporate power between inside and outside shareholders, it makes little sense to validate a decision which is the result of a mechanism that inside shareholders unfairly control. A system that allows corporate insiders to fund their campaign with shareholders' money, designate the timing of the decision, receive the ballots, and tabulate the results -- all in the absence of a confidential voting process -- should not be the basis for the decision that permanently disenfranchises millions of shareholders who have put their capital at risk and, regrettably, now beyond their control.

A recent study by James Heard and Howard Sherman on behalf of the Investor Responsibility Research Center concludes precisely this: that the proxy voting system is unfairly dominated by management and, consequently, is badly in need of reform. I have talked with most of the Commissioners about the need to ensure confidentiality of the proxy process for all matters for shareholder vote. I note that legislation recently introduced by Congressmen Rinaldo and Lent would require Commission rulemaking to accomplish this objective. A one share one vote mandate is meaningless absent a process that protects the integrity of the system for casting and tabulating shareholder votes. I would also propose that the Commission host a "roundtable" discussion to begin exploring the process of reforming the entire proxy mechanism. Reform of the proxy process is sorely needed and long overdue.

Any rule that sanctions unequal voting provisions may be susceptible to abuse by incumbent management. Unequal voting, if used as an anti-takeover device available at management's discretion, would violate one of the basic tenets of the Williams Act -- neutrality of the regulatory scheme between bidder and management. The drafters of the Williams Act took extreme care to balance the scales to protect the legitimate interests of the issuer, management, shareholders, and bidders in contests for corporate control. The importance of this tenet is underscored by the fact that Congress, in adopting the Williams Act, specifically rejected the pro-management approach to tender offer regulation that was originally proposed by Senator Harrison Williams. The rule proposed by the Commission may make available to managers an important defensive tactic. By violating the rule, perhaps intentionally, management can cause the company to be delisted, effectively preventing the public trading of a company's stock, thereby stopping offers for control. Although it is uncertain whether management would adopt this "doomsday" defense if it resulted in permanent delisting, it would be more attractive if the violation could be later "cured." I would hope that the courts would not permit managers to adopt this "doomsday" defense in contests for corporate control. On the other hand, from a public policy perspective, I can appreciate that the Commission might view a permanent delisting for a violation of the one share, one vote rule as too punitive a measure. The Commission needs to focus on this issue so as to strike the proper balance.

Another concern is that the Commission's rule may suffer from promising more than it can deliver. In a broad statement, which I wholeheartedly support, the rule prohibits corporate action having the effect of "nullifying, restricting, or disparately reducing" the voting rights of existing shareholders. The rule, however, permits the securities exchanges, with the approval of the Commission, to exempt securities issuances and other corporate action from the prohibition of the rule. Although the rule brings all of the exchanges up to a single standard, thereby stopping the "race to the bottom," the Commission must guard against becoming embroiled in the same controversy once again when the exchanges propose exceptions in an effort to gain a competitive advantage for new listings. The Commission will be compelled to entertain again the same arguments in favor of exceptions that it has examined in the current debate. For this reason, as a practical matter, I would prefer that the Commission specify in its rule the specific exceptions that it would authorize. This would lend certainty and stability to the regulatory process. I would urge the Commission to entertain these arguments now and resolve this issue once and for all. If it does not and the Commission instead chooses to entertain these exceptions on a case-by-case basis, I again stress the need for the Commission to hold the securities exchanges to the high burden of proof that the proposed standard mandates.

The focus of the Commission's proposed rule is protecting investors and the public interest from unequal voting rights plans that disenfranchise existing shareholders. Even more important, equal voting rights and common stock ownership are inextricably linked. Over 200 years of experience have established equal voting rights as a fundamental tenet of American democracy. If the Commission allows widespread adoption of unequal voting rights, corporate America's system of governance will become more elitist and aristocratic. It will lose its democratic moorings.

I commend the Commission and its staff for the progress they have made to date in making one share, one vote a reality. The Commission must remember, however, that the "one share, one vote" issue is simply one more battleground in the struggle between bidders and management in contests for corporate control. The Commission has judiciously avoided taking sides in that battle, and has sought to ensure that the system regulating contests for corporate control remain neutral and vibrant. I urge the Commission to continue to adhere to that position in the future by ensuring that one share, one vote is the rule, not the exception.

APPENDIX B

T. Boone Pickens, Jr.

General Partner

Mesa Limited Partnership

Testimony on One Share, One Vote

The Securities and Exchange Commission

December 17, 1986

Good morning, Chairman Shad and Members of the Commission. I'm Boone Pickens, General Partner of Mesa Limited Partnership and Chairman of the United Shareholders Association.

Mesa went public in 1964 and was listed on the New York Stock Exchange in 1969. Since then we have listed four additional securities on the Exchange.

The United Shareholders Association is a non-profit advocacy group dedicated to advancing the rights of America's 47 million shareholders.

I'm here today to ask the Commission to reject the New York Stock Exchange's request to drop its one share, one vote standard and to encourage you to implement a universal one share, one vote rule applicable to all exchanges.

INTRODUCTION

When Mesa went public in 1964, we did not consider the possibility of adopting anything other than one share, one vote. It wasn't even discussed. It was that fundamental. When Mesa Limited Partnership issued 90 million new preferred units in 1986, all of the units were afforded one share, one vote status, even though they have different financial characteristics and more than doubled the number of Partnership units outstanding. Clearly, we support one share, one vote not only in principle but also also in practice. In contrast, the executives of General Motors and a number of other large companies have pressured the New York Stock

Exchange to abandon its standard. The Exchange is bowing to that pressure. The Exchange itself has attested to the rule's usefulness and its fundamental role in assuring investor confidence. The compelling reasons for retaining the standard have not been challenged by the Exchange. Rather, the Exchange has based its request upon its competitive position relative to other exchanges that do not enforce a similar rule. The Exchange has stated publicly that it approved its proposed new voting rights policy reluctantly and continues to believe that the one share, one vote standard has served the market well and should be preserved. It has further stated that it approved the rule only after recognizing that it could neither promulgate the one share, one vote standard across all market centers, nor unilaterally maintain a voting rights standard not embraced by other market centers. Therefore, it is clear that the best resolution of the controversy is for the Commission to implement, through its regulatory authority, a one share, one vote standard across the board.

THE SPECTER OF AUTONOMOUS MANAGEMENT

The issue before the Commission today is profound. Approval of the Exchange's request would enable the executives of American industry, as a matter of public policy, to secure irrevocable autonomy from the owners of corporate assets. It would allow industry as a whole to slip free from the bridle of accountability held by the 47 millions Americans who bear the financial risk for the actions of management.

Those who frame this issue strictly as a matter of contract law disregard the vital role played by equal voting rights in the interdependent political and economic systems of checks and balances that keep America on an even keel. If disenfranchisement of shareholders is sanctioned by the Commission, how many managements will not choose to disenfranchise shareholders? The temptation to achieve permanent, autonomous control over assets owned by others at no cost to management is simply too great.

It is no coincidence that the one share, one vote issue has arisen at this point in time. For decades, the gap between ownership and control of corporate assets has been systematically widened. For the most part, shareholders stood idly by as this gap grew. In recent years, however, shareholders have begun to challenge management autonomy and exert pressure for improved performance. This expanding shareholder movement is enhancing corporate competitiveness and providing net economic benefits to the nation, but not without protests from those whose interests are served by the status quo. In the eyes of many managers, unequal voting rights have become the strategy of choice for escaping accountability to owners.

More than 200 years of experience have established equal voting rights as a fundamental tenet of American democracy. This tenet transcends the occasional willingness of elected groups of

The CHAIRMAN. Senator Armstrong.

OPENING STATEMENT OF SENATOR ARMSTRONG

Senator ARMSTRONG. Mr. Chairman, in the middle ages, kings of Europe claimed that they had the right to rule by divine appointment and the divine right theory of governance. That is exactly the theory of corporate governance, which is espoused very often increasingly during the last couple of years by some of the leaders of the great corporate firms of this country.

They have the idea that somehow they have a right, independent of their shareholders, to be in charge of the business affairs of these great corporations of which they have, in many cases, little or no ownership.

Now my notion is a little different—that they are, in essence, hired hands; that their relationship with their shareholders is sort of like that like a Senator to his constituents. He is hired by them upon a vote of a majority of the people who have an interest, and he or she or they are there to serve the interests of the people who are the ultimate authority. In the case of a Senator, that's the people who voted in his State. In the case of a corporate manager, I guess that's the people who own the stock in the corporation.

This has never been a particularly controversial issue so far as I know until the last couple of years when a number of entrenched corporations have been threatened by what they term "hostile" takeovers. In fact, I note that the New York Stock Exchange is represented here this morning and the one share/one vote concept has been, as far as I know, the norm on the New York Stock Exchange forever, up until very recently, when a number of companies decided that it would be convenient if a handful of shareholders had rights that were different from those of the general group of shareholders.

At the same time, in the face of what some of these corporate managers are pleased to call—incorrectly, in my judgment—hostile takeover—that term, Mr. Chairman, sort of calls to mind the imagery of a bunch of serfs storming the castle walls where the kings are ruling by divine right. What they call hostile takeovers, they have approached one State legislature after another to think up every kind of known device that they can erect to prevent people who buy shares in their corporations from exercising the rights of ownership, to elect directors, to buy and sell the property of the corporation, and to manage its affairs.

Indeed, in my own State of Colorado very recently, the legislature considered and almost adopted legislation of the most regressive kind which would do just that, which would say that, by gosh, if you have gotten yourself into a position of corporate management, just because somebody owns a majority control or elects a majority of the board, that doesn't mean that they have the right to run these corporations.

Now the issue of States rights has been raised and that's one to which I'm very sensitive and I expect every member of this committee is sensitive. Senator Sanford has raised it and properly so. But I want to tell you, that is the reddest herring I have ever heard of because we're talking about, by definition, corporations that are in interstate commerce. We're talking about Colorado shareholders who were disenfranchised recently in huge numbers by the Delaware legislative enactment which just is a protectionist measure. It just says that, by gosh, these Delaware corporations are not going to let Colorado shareholders have full rights of ownership unless it so happens that some Colorado citizen also happens to be a member of the board of directors or management of the Delaware corporation. And as we all know, that's where a disproportionate number of large corporations are domiciled in this country today.

I think this. There are 35 million Americans who are investors, shareholders, pension fund beneficiaries, and IRA shareholders, and it is this group of people who I think we ought to look out for first.

Second, I think we ought to be concerned with the efficiency of our capital markets because if this notion should catch on, that we're going to freeze in place entrenched managements and make it impossible for the owners of corporations to assert their prerogatives of management, I judge that in the long run our capital markets will be balkanized, that there will be much more difficulty in raising funds, that the price at which funds will be available to finance American business will be much less attractive, that our Nation's business firms will become much less competitive in international markets.

The bottom line is this. If we permit this trend to spread, shareholders will lose. The concept of national markets will lose. Interstate commerce loses and, in my judgment, our country loses.

Now having said that, let me make it clear I'm not really an alarmist, Mr. Chairman. As I understand it, at the present time, of the 5,500 publicly traded companies—that is companies traded on the American Stock Exchange, the New York Stock Exchange and NASDAQ—that 94.6 percent maintain a one share/one vote standard. So we're not talking about something that is the normal business practice. And of the remaining approximately 5 percent of companies, some of whom are represented in this room, many of those are ones that I would have no quarrel with because where I draw the line is this—if a company puts out an initial public offering and says right up front that we're not going to give you voting; all we're selling is an issue of preferred stock; all we're selling is some kind of a convertible issue; all we're selling is a second class issue; and people want to invest on those terms, then I have no quarrel with them. And, indeed, as my colleague from Pennsylvania pointed out, that has happened. Family firms that want to finance themselves or the Wall Street Journal or whoever it is that wants to maintain editorial independence—we've been trying to maintain editorial independence in our offices, despite the one man/one vote rule, haven't we?

I have no quarrel with a company that goes public and seeks the support of investors on that basis. Where I do have an objection and a serious one—not only an objection of philosophy but some very practical down-to-earth concerns—is where in some kind of a stage-managed attempt to prevent a hostile takeover a public company with a lot of shareholders cooks up some scheme in which they change the rules of the game and in effect disenfranchise a bunch of shareholders.

And I make that point because one of my good friends from Colorado is here and his company when it went public—and I think he's going to testify this morning—made it clear at the outset that they didn't intend to sell voting rights; they were selling investment rights, and I think that is an important distinction.

Well, suppose you have an election, Mr. Chairman, in which the shareholders themselves agree to give up the one share/one vote premise. Doesn't that solve the problem I'm concerned about? Well, I don't think so, any more than if a bunch of Senators by say a majority vote or a two-thirds majority vote or a three-quarters majority vote decided thereafter that only three Senators or six Senators were going to exercise the prerogatives that had been previously exercised by all 100 Senators, or if a group of citizens in my State of Colorado amended the State constitution to say thereafter we weren't going to have one citizen/one voter participation. Suppose we had an election and somehow mustered a majority to go back to the concept of you couldn't vote unless you owned property in the State?

I think the issue is far more fundamental than that and for that reason I'm just not impressed by the argument that because some entrenched management has convinced a majority—even a substantial majority of their shareholders who by and large are very passive unless things go wrong—I'm not persuaded that that makes it right.

Now, Mr. Chairman, I want to make two or three more points and then I will yield the floor and I've spoken already longer than I intended to but this is an important issue and I want to put this hearing in its correct frame of reference.

The New York Stock Exchange is here and someone has said—and I believe again it was Senator Sanford—what we ought to do is leave this matter to the exchanges. Well, now the New York Stock Exchange has had this rule. And the exact reason why this becomes a problem is because other exchanges are offering opportunities to list the securities of companies which want to change the rules on their stockholders, putting the New York Exchange in an untenable situation. You end up with a competitive bidding among the various exchanges for who will be most accommodating to some corporate management that wants to change the rules often in an unfair way.

I'm inclined to be flexible. I've introduced legislation, but I'm sure open to negotiation. The version of this measure that was passed—and I believe I'm correct in saying it was actually adopted by the House of Representatives—is more or less acceptable to me. I'm not against preferred stock. I'm not against IPO's that contain explicit limitations on shareholder participation if that's the ground rules at the beginning, but in one way or another I want to stop the spread of this notion that somehow we're going to freeze these managements in place.

So I'm a one share/one vote man, but willing to negotiate on exactly how that principle ought to be applied.

The CHAIRMAN. Thank you, Senator Armstrong.

Senator D'Amato.

OPENING REMARKS OF SENATOR D'AMATO

Senator D'Amato. Mr. Chairman, I was only here for a portion of my colleague and friend, Senator Armstrong's remarks, but let me say that I associate myself with that portion that I heard. He very cogently spelled out the dilemma that exists of the problem, the balance between corporate democracy, a recognition where family founded or family managed companies legitimately have a right to use this as a mechanism for funding as distinguished from those who seek to ensure corporate incumbency and don't give a hoot and a holler about the shareholders.

So I would like to associate myself with his remarks and say I look forward to working with Senator Armstrong. I might suggest that to date the SEC's proposed rule, I believe, satisfactorily addresses both the legitimate needs of the dual class capitalization and the goals of corporate democracy.

Now there have been some who would contest whether or not the SEC has rule making authority in this area, and it would seem to me that we could and should review legislative action that would be rather simple and confer upon the SEC that authority, so there's no mistake about it. So that would be one way in which we could handle that.

Mr. Chairman, I'm going to ask that the balance of my remarks be included in the record as if read them in their entirety, but I do think that it will take some courage on our part to stand up to the boards. And I tell you, to date, we have demonstrated the whimp factor that we often accuse the administration of to a pretty great extent. We don't have it. The Business Roundtable and groups come in here and tell us of their tales of woe and we just buckle under and run with them. We're afraid that they're going to campaign against us, work against us, and not give us any of those PAC contributions that we all disclaim. We don't want those PAC's to give us any money because we know it's never going to get passed so it's great to be against PAC's. You can see that every day, we don't want PAC contributions. We put that legislation and in the meantime the same guys who are voting to do away with them are taking them. That would be another test, Mr. Chairman. At least you have always lived up to that rule and not taken anything more than $100 I think or anything? One hundred dollars for your whole campaign?

The Chairman. And I paid it out of my pocket.

Senator D'Amato. So when Bill Proxmire takes that position it has some credibility, but the rest of us it's a lot of nonsense. So we're already to decry the PAC's, but by the same token they won't stand up to corporate America as it relates to their looking to insulate themselves from the very people who own the corporations.

I've talked too long. I'm going to ask that my remarks be included in the record.

The Chairman. Without objection, so ordered.

[The complete prepared statement of Senator D'Amato follows:]

individuals to disenfranchise themselves and their successors for all time in exchange for temporal rewards. If the Commission allows widespread adoption of unequal voting rights, corporate America's system of governance will become more elitist and aristocratic. It will lose its democratic moorings. The separation of ownership and control will become final and complete.

THE COST OF UNEQUAL VOTING RIGHTS

Consider the aggregate value of the assets controlled by America's publicly owned corporations. The depreciated historical cost, or book value, of the assets managed by the 200 corporations represented by the Business Roundtable is approximately $2.5 trillion. The actual, inflation-adjusted value of those assets substantially exceeds the depreciated historical cost. Taking into consideration the value of assets controlled by the more than 6,000 other publicly owned corporations, corporate America's total asset value easily exceeds $10 trillion. This represents the vast majority of the nation's wealth, and the uses to which this wealth is put and the way in which it is managed have enormous consequences for all Americans.

The inherent danger of concentrating control in the hands of insiders who do not bear a proportionate share of financial risk led the New York Stock Exchange to adopt its one share, one vote standard in 1926. In so doing, the Exchange recognized a basic ingredient of our economic system: that those who control assets or wealth must be accountable to those who bear the financial risk. Exposure to the competitive pressures of the marketplace provides the necessary incentives for maximizing productivity and profitability within America's free market system. In an increasingly global economy, the need for accountability to owners is greater today than ever before. Rather than abandon the economic incentives that have allowed our economy to flourish, we must revitalize those incentives by reinforcing accountability.

MANAGERS, NOT SHAREHOLDERS, WANT UNEQUAL VOTING RIGHTS

There is no demand by shareholders for stock with inferior voting rights. There is no logical reason for shareholders to request the creation of stock with inferior voting rights. All unequal voting rights plans adopted to date have been proposed by incumbent managers. They have served to entrench managers against shareholder efforts, either real or perceived, to hold them accountable for their performance. Managers propose unequal voting rights to preserve their control. No other rationale for unequal voting rights will stand the test of reasoned analysis. Homestead Financial Corporation stated that it proposed a recently adopted unequal voting rights plan so it could raise additional capital without losing control. To whom was the company afraid of losing control? Its owners?

Allowing unequal voting rights for common stocks would sound the death knell for shareholder rights. The fundamental right of equity owners to participate in corporate governance on an equal basis is the foundation upon which all other shareholder rights rest. Without equal voting rights, the right of equity holders to vote for board members, recapitalization plans, mergers and other issues directly affecting share value would be reduced to empty symbolism.

UNEQUAL VOTING RIGHTS PERMANENTLY DISENFRANCHISE HOLDERS

Once in place, unequal voting rights make it virtually impossible for shareholders to discipline management, no matter how poor its performance.

Unequal voting rights permanently disenfranchise public shareholders. Once a plan is approved, it is impossible for the shareholders with diluted voting power to reclaim full voting rights.

PRINCIPLES OF EQUAL TREATMENT ARE BEING IGNORED

The principles of equal treatment for all shareholders endorsed by Congress in enacting the Williams Act and espoused by the Commission in promulgating the "all holders" rule logically extends to the concept of one share, one vote. Unequal voting rights are nothing more than attempts to classify shareholders into separate categories, giving one class an ability to override a second class, even if that second class bears the bulk of the financial risk. The class of stock with the comparative advantage is invariably owned or controlled by insiders.

Unequal voting rights effectively freeze shareholders who hold reduced voting right stock out of the corporate control process.

THE NEW YORK STOCK EXCHANGE'S PROPOSAL

Though it proposes to make one of the most fundamental rule changes in its history, the Exchange did not follow the most rudimentary standards of due process in its efforts to substantiate the need for dropping its standard.

The Exchange reached its decision to drop the one share, one vote standard without meaningfully consulting shareholders. Of more than 3,000 surveys distributed by the Exchange, only 63 were sent to major institutional investors. Approximately 1,500 were sent to companies, 700 to lawyers and 900 to academics and others. Shareholders represented only 2 percent of the sample. Managements represented 50 percent. The Exchange was only able to obtain an 8 percent positive response from those surveyed.

The Exchange's proposal contains neither an analysis of the impact of the change, nor a discussion of the original justification for the rule.

The Exchange's filing cites four alleged reasons why one share, one vote is no longer needed:

1. That "increased sophistication" of investors, especially due to the increased involvement of institutional

investors, reduces the need for the protection provided by one share, one vote.

Increased sophistication would support enhanced voting responsibility rather than a reduced role in corporate governance. Of what value is increased sophistication if the shares owned lack an effective vote?

Besides, one of the greatest weaknesses of the current system is that institutional investors often are subjected to tremendous pressure to vote with management. In many cases, they do not vote at all. This is true even when their actions are not in the financial interests of their beneficiaries.

2. That the oversight provided by independent directors reduces the need for one share, one vote.

If stockholders other than management have little or no voting power, how can any director be classified as independent? Even under the current system, few directors could be deemed truly independent since they are generally selected by the chief executive officers and are beholden to management.

3. That the requirement for an audit committee composed of independent directors protects all shareholders, even those with reduced voting power.

The audit committee has no function in the management of a corporation's assets. The theoretical purpose of the audit committee is to protect against internal fraud and abuse. It is no substitute for shareholder participation in corporate governance.

4. That extensive corporate disclosure eliminates the need for one share, one vote.

Increased disclosure is useful to shareholders because it provides information on which to base their actions, including voting. In the words of Bob Monks of Institutional Shareholders Services, Inc., "Disclosure enhances a shareholder's ability to vote, it does not replace it."

THE EXCHANGE'S COMPETITION ARGUMENT IS FLAWED

The Exchange's request is based on its theory that it will soon lose business to other exchanges with lower voting standards. The American Stock Exchange has considerably weaker voting standards. The over-the-counter market has no voting standards.

The competition argument ignores the fact that the New York Stock Exchange dwarfs the other exchanges.

As a result of the Exchange's action, the American Stock Exchange, citing the need to "remain competitive," has voted to remove its standards entirely.

If the Commission approves the Exchange's proposal, the "race to the bottom" will be on. Abandonment of the rule will set a precedent for reducing standards any time an exchange anticipates increased competition, even when that perceived competition is unsubstantiated. The way to protect the New York Stock Exchange's competitive position is to apply a uniform standard across the board, not to embark on a debilitating regression toward standardless securities markets.

SUMMARY

American Stock Exchange Chairman Arthur Levitt described the value of the one share, one vote standard in a recent letter to the Commission: "We think public shareholder voting is a key element of corporate accountability and that the loss of such accountability conflicts with the traditional role of shareholders as the ultimate owners and controllers of the corporation. We see it as fundamentally unfair procedure -- and in the long run extremely unwise social policy -- that large corporations should be able to reap the advantages of being publicly held while, at the same time, enjoying the advantages that accrue to privately held companies whose managements are accountable to themselves alone." In 1985, New York Stock Exchange Chairman John Phelan praised the Exchange's standard in testimony before Congress: "The Exchange believes the qualitative listing standards developed and refined over the past half-century or more -- including the one share, one vote policy -- have been good for its listed companies, good for their shareholders and good for this country . . . Over the years the one share, one vote policy has served the market well. Philosophically, the Exchange still believes in it. In an ideal world, most people would probably want it to be retained." This position was reiterated in the Exchange's filing with the Commission.

The New York Stock Exchange and the American Stock Exchange have endorsed one share, one vote. The future of our capital markets and this country's prosperity depend on the Commission's leadership. As a veteran who has fought in the trenches of our free market system and as an advocate of the rights of all shareholders, I urge you to take the high road and implement a universal one share, one vote standard. Thank you.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

MARCH 17, 1988

THIS MORNING WE CONTINUE TO GRAPPLE WITH AN ISSUE THAT HAS CONFRONTED CORPORATE AMERICA, THE SELF-REGULATORY ORGANIZATIONS AND THIS COMMITTEE SINCE 1985. THAT ISSUE CONCERNS THE NATURE AND EXTENT OF THE ROLE THAT CORPORATE SHAREHOLDERS WILL PLAY IN CHECKING THE POWER OF CORPORATE MANAGERS AND DIRECTORS. TODAY, WE ARE CONFRONTED WITH A SITUATION WHERE, FOR A VARIETY OF REASONS, THE INPUT OF SHAREHOLDERS IN THE RUNNING OF CORPORATE AMERICA MAY BE SERIOUSLY JEOPARDIZED.

THE ISSUE IS OFTEN REFERRED TO AS "CORPORATE DEMOCRACY" OR "ONE SHARE/ONE VOTE" OR "DUAL CLASS CAPITALIZATION." ALL OF THESE TERMS REVOLVE AROUND THE CENTRAL ISSUE OF THE RELATIONSHIP OF SHAREHOLDERS, THE REAL OWNERS OF THE COMPANY, AND THE CORPORATE MANAGERS WHO ARE EMPLOYED BY THE SHAREHOLDERS TO MANAGE THE DAY TO DAY AFFAIRS OF THE COMPANY. RECENTLY, THE CONCEPT OF CORPORATE DEMOCRACY HAS COME UNDER ATTACK BY THOSE CORPORATIONS THAT HAVE SHIFTED FROM THE TRADITIONAL ONE SHARE/ONE VOTE STANDARD TO A DUAL TYPE CAPITALIZATION STRUCTURE. THE REASON FOR THIS SHIFT VARIES. IN THE CASE OF GENERAL MOTORS, THE COMPANY ISSUED STOCK WITH DISPARATE VOTING RIGHTS AS PART OF AN ACQUISITION PROGRAM. IN OTHER CASES, THE SHIFT HAS BEEN USED AS A METHOD OF DEFENDING AGAINST UNWANTED TAKEOVERS. THE EFFECT OF THIS SHIFT BY NYSE LISTED COMPANIES HAS BEEN TO FORCE THEM INTO NON-COMPLIANCE WITH THE NYSE'S ONE SHARE/ONE VOTE RULE. IN TURN, THE SHIFT OF THESS COMPANIES TO DUAL CAPITALIZATION STRUCTURES HAS FORCED THE NYSE TO RECONSIDER THE VALIDITY OF THE ONE SHARE/ONE VOTE RULE OR LOSE LISTINGS TO OTHER EXCHANGES (AMEX AND NASD) THAT DO NOT ADHERE TO A ONE SHARE/ONE VOTE STANDARD. THUS, THE NYSE IS UNDER PRESSURE BY ITS LISTED COMPANIES AND DOMESTIC AND FOREIGN COMPETITORS TO CHANGE ITS LISTING STANDARDS.

THE ABANDONMENT OF THE ONE SHARE/ONE VOTE STANDARD MAY NOT BE THE DEATH

KNELL OF CORPORATE DEMOCRACY, BUT IT HAS DRAMATIC IMPLICATION FOR THE CONCEPT OF CORPORATE ACCOUNTABILITY. IF THE POWER OF SHAREHOLDERS OVER MANAGEMENT IS FURTHER ERODED, THEN WHO WILL PROVIDE A CHECK OVER CORPORATE MANAGERS TO ENSURE CORPORATE ACCOUNTABILITY? FURTHER, THE ANTI-TAKEOVER LEGISLATION EMBODIED IN S.1323 FURTHER PROTECTS MANAGEMENTS FROM THE OUTSIDE PRESSURES OF CORPORATE TAKEOVERS AS WELL AS CORPORATE SHAREHOLDERS. THE INSULATION OF MANAGEMENTS THROUGH THE USE OF FEDERAL AND STATE ANTI-TAKEOVER LEGISLATION COMBINED WITH PROPOSALS TO DIMINISH SHAREHOLDER VOTING POWER WILL REMOVED THE MOST EFFECTIVE MEANS OF HOLDING CORPORATE MANAGERS ACCOUNTABLE FOR THEIR ACTIONS. THE ONLY MECHANISM LEFT FOR THE REMOVAL OF CORPORATE MANAGERS WILL BE BANKRUPTCY.

IN THE ABSENCE OF MARKET MECHANISMS SUCH AS CORPORATE TAKEOVERS AND THE DIMINUTION OF THE SHAREHOLDER VOTES CAN ONLY RESULT IN MORE GOVERNMENT INTERVENTION INTO THE DAY TO DAY CONDUCT OF CORPORATE AMERICA TO ENSURE THAT CORPORATIONS ARE ACCOUNTABLE TO THEIR CORPORATE CONSTITUENTS. IN THE PAST WE HAVE OBSERVED WHAT CONGRESS WILL DO TO ENHANCE CORPORATE ACCOUNTABILITY. THE FEDERAL SECURITIES LAWS, THE FEDERAL LABOR LAWS, THE FEDERAL ENVIRONMENTAL LAWS, THE FOREIGN CORRUPT PRACTICES ACT AND THE FEDERAL ELECTION LAWS WERE ALL DESIGNED TO CORRECT THE DEFICIENCIES OF CORPORATE MANAGEMENTS WHO ENGAGED IN ACTIVITIES THAT WERE CERTAINLY AT ODDS WITH THEIR CORPORATE CONSTITUENCIES.

SAYING THIS, I REALIZE THERE ARE LEGITIMATE REASONS FOR DUAL CLASS CAPITALIZATIONS WITH DISPARATE VOTING RIGHTS — ESPECIALLY IN THE CASE OF FAMILY FOUNDED, FAMILY MANAGED COMPANIES. TO DATE, THE SEC'S PROPOSED RULE SATISFACTORILY ADDRESSES BOTH THE LEGITIMATE NEEDS OF DUAL CLASS CAPITALIZATION AND THE GOALS OF CORPORATE DEMOCRACY. WE SHOULD EITHER ACT TO CODIFY THE SEC PROPOSED RULE OR GRANT THE SEC THE SPECIFIC AUTHORITY TO PROMULGATE THE RULE SINCE SOME COMMENTATORS SUGGEST THE SEC LACKS THE AUTHORITY TO PROMULGATE THE RULE. I LOOK FORWARD TO TODAY'S HEARING AND HOPE THAT WE COULD ACHIEVE A SWIFT RESOLUTION OF THIS ISSUE ON THE SENATE FLOOR.

The CHAIRMAN. Senator Graham.

OPENING REMARKS OF SENATOR GRAHAM

Senator GRAHAM. Mr. Chairman, I don't have an opening statement.

I would say that I come to this from the presumption that a corporation should have the right to organize itself in the manner which it feels best serves its purposes as long as all those affected by that decision are fully aware of it and can take it into account in making judgments as investors as to whether that's a corporation that they choose to invest in.

I frankly don't find the analogy to one man/one vote in a political context very persuasive as it relates to a corporate context. Each of us, as a general proposition, is limited to being a citizen of one nation and the resident of one community. We all have the opportunity, however, to be economically participants in many different entities and have the opportunity to make judgments as to whether the structure of that particular corporation is one that we choose to invest in.

So I start from a position that's going to require some persuasion that Federal involvement is appropriate in terms of the political composition of an economic corporate entity.

The CHAIRMAN. Thank you, Senator Graham.

Senator Chafee.

Senator CHAFEE. Mr. Chairman, I have some skepticism about this one share/one vote and have a statement here I would like to submit for the record. I'd be interested to hear and read what the testimony is on the matter.

The CHAIRMAN. Without objection, so ordered.

[The complete prepared statement of Senator Chafee follows:]

SPEECH BY
SENATOR JOHN H. CHAFEE
TO
SENATE BANKING COMMITTEE
ON ONE SHARE/ONE VOTE
(MARCH 17, 1988)

MR. CHAIRMAN. I APPRECIATE YOUR WILLINGNESS TO HOLD HEARINGS TODAY ON ONE SHARE/ONE VOTE.

THE RHETORICAL APPEAL OF ONE SHARE/ONE VOTE IS LIKE THAT OF ONE MAN/ONE VOTE. IT APPEARS TO BE SO DEMOCRATIC AND SO AMERICAN. BUT WE MUST LOOK CAREFULLY AT THE ISSUE BEFORE WE ACCEPT SUCH A COMPARISON AT FACE VALUE.

I HAVE THREE PARTICULAR CONCERNS ABOUT ONE SHARE/ONE VOTE. FIRST, WHETHER THIS WOULD NOT PREEMPT THE RIGHT OF CORPORATIONS TO ALLOW DIFFERENT VOTING RIGHTS. SECOND, WHETHER THIS IS TRULY DEMOCRATIC. THIRD, WHETHER THIS UNFAIRLY RESTRICTS CORPORATE FINANCING METHODS.

MY FIRST CONCERN IS BASED ON THE RIGHT OF CORPORATIONS, WHICH ARE CHARTERED BY STATES, TO SET THEIR OWN VOTING RIGHTS. JUSTICE POWELL, WRITING THE MAJORITY DECISION IN THE RECENT SUPREME COURT

CTS CASE, ASSERTED THAT "[N]O PRINCIPLE OF CORPORATION LAW AND PRACTICE IS MORE FIRMLY ESTABLISHED THAN A STATE'S AUTHORITY TO REGULATE DOMESTIC CORPORATIONS, INCLUDING THE AUTHORITY TO DEFINE THE VOTING RIGHTS OF SHAREHOLDERS." A FEDERAL LAW TO LIMIT A CORPORATION'S VOTING RIGHTS TO ONE CLASS WOULD DOUBTLESS CONFLICT WITH ALMOST ALL STATE CORPORATION LAWS. THIS WOULD NOT ONLY, FOR EXAMPLE, PUT POISON PILLS UNDER A CLOUD, BECAUSE THEY PERMIT CURRENT SHAREHOLDERS TO ACQUIRE SHARES AND VOTING RIGHTS ON MORE FAVORABLE TERMS THAN THOSE AVAILABLE TO THE RAIDER. THIS WOULD ALSO PROBABLY OVERTURN THE CTS DECISION AND OTHER STATE LEGISLATION TO REDUCE CORPORATE VULNERABILITY TO TAKEOVERS.

MY SECOND CONCERN IS THAT ONE SHARE/ONE VOTE COULD BE UNDEMOCRATIC. THE CRITICAL NEED, IN MY VIEW, IS FULL AND FAIR DISCLOSURE TO CURRENT AND POTENTIAL SHAREHOLDERS OF THEIR RIGHTS. IF CURRENT SHAREHOLDERS WANT TO ALTER THEIR VOTING RIGHTS, A ONE SHARE/ONE VOTE FEDERAL LAW WOULD IN FACT DIMINISH THEIR RIGHTS AS SHAREHOLDERS BY LIMITING THEIR SAY IN THEIR OWN CORPORATION. THE SHAREHOLDERS SHOULD BE ABLE TO STRUCTURE THE VOTING RIGHTS AS THEY SEE FIT, AS LONG AS SUCH APPROACH IS DIVULGED TO THE INVESTING PUBLIC, AND NOT DONE ON THE SLY, OR IN AN UNDERHANDED OR COERCIVE WAY.

MY THIRD CONCERN IS THAT ONE SHARE/ONE VOTE WILL UNFAIRLY LIMIT CREATIVE FINANCING APPROACHES BY BUSINESS. FAMILY-CONTROLLED

COMPANIES, WHERE THE FAMILY SEEKS TO RAISE EQUITY CAPITAL WITHOUT LOSING CONTROL, WOULD BE FRUSTRATED BY ONE SHARE/ONE VOTE. INVESTORS IN PUBLIC COMPANIES, LIKE WANG LABORATORIES OR THE DOW JONES COMPANY, SEEMED NOT TO HAVE BEEN DETERRED BY A DUAL CLASS STRUCTURE. ADDITIONALLY, INNOVATIVE CAPITALIZATIONS WOULD BE CURTAILED. GENERAL MOTORS, FOR EXAMPLE, ESTABLISHED A SEPARATE CLASS OF STOCK FOR THE ACQUIRED EDS, WHERE EDS' PERFORMANCE COULD BE REFLECTED IN THE RETURN TO EDS' OLD SHAREHOLDERS, SEPARATE AND APART FROM THE LARGER PARENT. WHY SHOULD THESE CREATIVE IDEAS GO BY THE BOARDS?

MR. CHAIRMAN. IF THESE THREE CONCERNS CAN BE SATISFACTORILY ADDRESSED BY LEGISLATION THEN I WOULD BE WILLING TO CONSIDER IT. I AM RELUCTANT TO UPSET CURRENT CORPORATE CONTROL OF VOTING RIGHTS, SHAREHOLDER DECISION-MAKING, AND INNOVATIVE FINANCIAL ARRANGEMENTS FOR THE SAKE OF A SWEEPING IDEA WHICH HAS NOT BEEN SUFFICIENTLY THOUGHT THROUGH AS TO ITS POTENTIALLY HARMFUL RAMIFICATIONS.

The **Chairman**. Thank you, Senator Chafee. I would like at this time to insert in the record statements of Senators Dixon and Sasser.

[The complete statements of Senators Dixon and Sasser follow:]

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I am pleased that the committee is holding this hearing to consider what I think is one of the most misunderstood issues in the securities area today.

One share/one vote—it sounds like apple pie; like everything that's good about America; like the next step in the struggle for civil rights.

Well, let me tell you—it isn't. One share/one vote has no relation whatsoever to one man/one vote—the pronouncement of the U.S. Supreme Court in *Baker* v. *Carr*—a case that arose in the early 1960's because of the misapportionment of the legislature in my own State. If this was really democracy in action, it would be one shareholder/one vote. I always thought the idea was that every person, regardless of their wealth or holdings should have equal access to the process.

One share/one vote favors those that can acquire enormous quantities of stock: large institutions and corporate raiders. It works against small shareholders and those that hold for the long term. And it works against companies that want to make investments in research and development, it creates an inordinate emphasis on the short term share price.

One share/one vote is a rule of the New York Stock Exchange only. It's not a rule of any Federal or State agency, or any other exchange. It was instituted in 1926, in a different time, when there were no Federal securities laws governing disclosure and proxy contests, and it was instituted in a different situation, when business leaders were building strong companies that invested for the long term and were not continually the subject of hostile takeovers.

Indeed, one share/one vote is an invasion of the Federal Government into an area where it has no business or previous role—State corporate law.

If a company discloses when it sells stock what the voting rights are, in exchange for a lower or higher price or dividend—it's a bargained for exchange, a contract between two parties. What business is it of ours how a company structures itself or raises capital as long as it makes full disclosure to the shareholders, and they approve it, as is required under current law?

If a company wants to raise capital but at the same time retain its control or managerial style (maybe just maybe the company wants to manage for the long term), if the company wants to protect itself from a takeover, that's a reasonable decision. If investors don't think so, they won't buy the stock.

Indeed, I am pleased that today we will hear from John Hechinger, whose company has disparate voting rights, but at the same time returns great value to his shareholders, employees and the community, and can manage without the threat of a hostile takeover.

Thank you, Mr. Chairman.

The CHAIRMAN. You gentlemen are very patient. You have listened to considerable talk up here.

Mr. Goldin, I understand you have to leave early. I want to commend you on wearing a green tie this morning. Most of us missed the boat. I guess, Mr. Warner, I can't tell if that's a green tie or not.

Mr. **Warner**. Yes.

The **Chairman**. At any rate, my grandparents, Pat Flanagan and Rose O'Reilly on my mother's side would be very proud of both you gentlemen.

Go right ahead.

STATEMENT OF HARRISON J. GOLDIN, COMPTROLLER, NEW YORK CITY, NY

Mr. **Goldin**. Thank you very much. Mr. Chairman and members of the committee, you wouldn't expect less than a green tie from and old "Goldin" on March 17, would you, Mr. Chairman?

The **Chairman**. Of course.

Mr. **Goldin**. I appreciate the opportunity to be with you again and hope the committee will understand, as I explained when I accepted the invitation, that after delivering my remarks I leave to engage in a required and pleasurable ritual of the day, our annual march in New York up Fifth Ave.

However, I'm glad you've given me a chance to present my views on a matter of great importance to shareholders.

[The complete prepared statement of Harrison J. Goldin follows:]

MARCH 17, 1988

Alan Dixon

STATEMENT OF SENATOR ALAN DIXON

SENATE BANKING COMMITTEE HEARING
ON
ONE SHARE/ONE VOTE

MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS MORNING AS THE COMMITTEE CONDUCTS HEARINGS ON THE NEED FOR LEGISLATION THAT WOULD PROHIBIT A CORPORATION FROM BEING LISTED ON A NATIONAL SECURITIES EXCHANGE UNLESS EACH SHARE OF ITS COMMON STOCK INCLUDES THE RIGHT TO CAST ONE VOTE; THE SO CALLED ONE SHARE/ ONE VOTE LEGISLATION. WE HAVE A DISTINGUISHED GROUP OF WITNESSES BEFORE THE COMMITTEE TODAY, AND I'M SURE THEIR TESTIMONY WILL BE OF GREAT VALUE TO US.

THE COMMITTEE HAS EXAMINED THIS ISSUE ON PREVIOUS OCCASSIONS AND MOST RECENTLY DECIDED THE BEST ACTION TO TAKE WAS TO ASK THE SEC TO STUDY THE IMPACT OF ONE SHARE/ ONE VOTE. I AM INTERESTED

IN LEARNING EACH OF YOUR VIEWS AS TO WHAT OTHER STEPS SHOULD BE TAKEN BY THE COMMITTEE, IF ANY, BEFORE THE SEC REPORTS BACK TO THE COMMITTEE IN OCTOBER.

IN MY OWN VIEW, I BELIEVE WE MUST EXAMINE THE BENEFITS OF EACH OPTION. ON THE ONE HAND WE MUST CONSIDER ALL THE BENEFITS DERIVED FROM THE INNOVATIVE FINANCING TECHNIQUES THAT HAVE PROMOTED THE GROWTH OF MANY NEW COMPANIES IN THE PAST FEW YEARS, WHILE ON THE OTHER HAND, REMEMBERING THE BENEFIT OF "CORPORATE DEMOCRACY" THAT WOULD BE ACHIEVED THROUGH THE ADOPTION OF THE ONE SHARE/ ONE VOTE RULE. WE ALSO NEED TO CAREFULLY CONSIDER WHETHER FEDERAL ACTION IS THE BEST WAY TO ADDRESS THIS QUESTION, OR WHETHER THE PROPER COURSE IS TO CONTINUE TO PERMIT THE STATES AND THE SECURITIES EXCHANGES TO EXERCISE JURISDICTION.

I LOOK FORWARD TO HEARING FROM THIS MORNING'S WITNESSES. I'M SURE THEIR TESTIMONY WILL BE OF GREAT VALUE TO THE COMMITTEE AS WE ATTEMPT TO REACH A CONSENSUS ON WHICH DIRECTION TO PROCEED WITH ONE SHARE/ ONE VOTE.

TESTIMONY BY
NEW YORK CITY COMPTROLLER
HARRISON J.GOLDIN
U.S. SENATE COMMITTEE ON BANKING
HEARING ON ONE-SHARE ONE-VOTE
DIRKSEN SENATE OFFICE BUILDING, ROOM SD-538
WASHINGTON, D.C.
THURSDAY, MARCH 17, 1988, 10:00 A.M.

Mr. Chairman, members of the Committee. I appreciate the opportunity to be with you again. I am especially glad you have given me the opportunity to present my views on a matter of great importance to shareholders.

I appear before you as Comptroller of the City of New York and a shareholder. For as Comptroller I am the asset manager, custodian or trustee of five public employee pension funds whose aggregate assets exceed $30 billion. Those assets, which are invested in more than 1,300 American companies, represent the retirement security of nearly 500,000 current and former New York City employees.

I also represent the Council of Institutional Investors. The Council, as some of you know, comprises approximately 50 pension funds--most of them for municipal or state employees--from across the nation. I am a founder of the Council and one of its co-chairmen.

It is for these funds, as well as New York's--and for the millions of taxpayers who contribute to our public pension funds--whose interests in this regard are co-terminous with those of millions of other American investors, that I urge you to vindicate a fundamental principle of corporate democracy, that management holds assets proportionately for all shareholders and that all shareholders, therefore, must have the same right to participate in determining how those assets are to be managed.

This concept of one-share-one-vote has dominated our securities markets for more than 60 years; its dilution would diminish the value of the assets I hold in trust. Studies by the Securities and Exchange Commission and others have substantiated that empirically.

That this should be so is no surprise to us in the public sector. For full enfranchisement promotes accountability, which engenders a high degree of care, which produces a high standard of stewardship. Indeed, that is the foundation of our political system. In a world of public ownership of companies, if corporate democracy is to mean anything at all, that is what we should require, too, in the structure and governance of corporations.

Even as in our political lives we have certain inalienable rights, so, too, should we have rights as corporate shareholders that reflect values which are so basic they must be protected specially, precluding even a majority of one generation of shareholders from compromising them enduringly. Chief among those values is one-share-one-vote.

Simply put, certain critical decisions affecting the value of assets inure definitionally to owners--not management. As

The CHAIRMAN. Thank you very much, Mr. Goldin. We very much appreciate your testimony and I hope you have a good march in New York.

Mr. GOLDIN. Thank you.

The CHAIRMAN. Our next witness is Mr. Richard Grasso, executive vice president of the Capital Markets, New York Stock Exchange, New York.

Mr. Grasso, I should have warned Mr. Goldin—he stayed within it, but this will mark your time. You have 10 minutes and the green light is not St. Patrick's Day, that's when you can go, and the red light is to stop. Go right ahead.

Senator ARMSTRONG. Mr. Chairman, before Mr. Grasso proceeds, were you indicating Mr. Goldin would be leaving before the panel completed their testimony?

The CHAIRMAN. He has to leave. He has to catch a plane and he has to march in the parade.

Senator ARMSTRONG. I don't want to delay the proceedings and I don't want to take the time to address any questions to him at this point, but just to congratulate him on an excellent statement and very well said. Thank you.

Mr. GOLDIN. Thank you, Senator. I can stay long enough to hear that. Thank you.

Senator SHELBY. Mr. Chairman, I know that he has to leave and I can see the tie and the date that we're observing today. I wondered if he would be willing to respond to some questions that we might propound to him that would be made part of this record. I know the chairman and Senator Armstrong and perhaps some others have some.

The CHAIRMAN. That's a very good suggestion. We will make the questions available to you and you can respond in writing.

Senator SHELBY. And that will be part of the record, will it not?

The CHAIRMAN. Yes.

Mr. GOLDIN. I very much welcome the chance to do that and I might say to the Senators that should there be any other appropriate forums in which you want me to expand on my comments, I'd be glad to do that, too.

Senator SHELBY. Thank you.

The CHAIRMAN. Mr. Grasso, go ahead, sir.

STATEMENT OF RICHARD A. GRASSO, EXECUTIVE VICE PRESIDENT, NEW YORK STOCK EXCHANGE

Mr. GRASSO. Thank you, Mr. Chairman and members of the committee. I welcome this opportunity to review the New York Stock Exchange's position on the subject of shareholder voting rights.

[The complete prepared statement of Richard A. Grasso follows:]

shareholders, we reject the notion that we need protection from ourselves. But we do need protection of our fundamental rights.

Arguably, institutional investors such as those I represent are not the prototypical small, independent shareholder. But large or small, we are shareholders nonetheless. Indeed, we clearly are the shareholders of the future, because the proportion of the market accounted for by the institutional investor continues to grow.

Despite our size, however, we are concerned that many of our fundamental ownership rights are widely threatened by the tyranny of a minority so afraid of accountability and the danger it poses to their hegemony that they threaten to disrupt the very system that has allowed them to prosper.

That is why the first article of the Shareholder Bill of Rights developed by the Council of Institutional Investors states: "The right to vote is inviolate and may not be abridged in any circumstance or by any action by any person."

Corporate managements that dilute the votes of some shareholders frequently argue that they do so to protect their companies from hostile assault. In truth, however, the action is often designed simply to protect incumbent management and insulate it from effective accountability. Indeed, it is ironic that in protecting themselves against takeovers, they perpetrate the ultimate takeover--from the inside and without investment or risk.

Fortunately, only a handful of the firms that have chosen the benefits of public listing on the premier stock exchange in the country, the New York Stock Exchange, challenge the NYSE's one-share-one-vote rule that has protected the rights of all shareholders for more than 60 years and set the standard for other exchanges. Indeed, so ingrained is this tenet of corporate democracy that only a handful of firms listed on the American Stock Exchange and the NASDAQ market system have abandoned it, either.

Unfortunately, a few selfish corporate managements that seek to entrench themselves have been able, in disproportionate strength, to apply competitive pressure on the public securities exchanges. We do not believe that abrogation of the fundamental principle of one-share-one-vote is warranted in a rush to the bottom. Indeed, we urge that all environments in which the shares of public companies trade be elevated to the highest standard.

Those who recall my testimony and that of my fellow members of the Council of Institutional Investors before this Committee on other matters know that we do not want to inhibit the vitality of securities markets by over-regulation. But our basic rights as shareholders must be protected.

Companies are in the main governed by state law, which is properly parochial, and bidders by Federal law, which is designed to ensure an orderly process in the nation's capital markets. Who, then, is left to be concerned with the rights of shareholders in this matter? In the absence of an agreement by the exchanges themselves to preserve the essence of corporate democracy we hope the SEC will act. I and my colleagues have so urged it at several public sessions, where the testimony overwhelmingly supported our position. The Commission is studying a regulation that encompasses many of our concerns. You have the ability at least to underscore its authority in this matter.

And if it fails to act, or acts in a manner that does not fully protect shareholders, then I hope you will intercede. I surely do not need to remind this Committee that Congress has acted before as necessary to impose minimal levels of Federal standards and regulation. One-share-one-vote poses no more an issue of preemption of states' rights than Congressional action to protect consumers and the environment in areas in which state regulation has been inadequate.

As investors whose participation in the nation's securities markets furthers the essential purpose of those markets, namely to facilitate capital formation in the interest of growth and a fuller realization of the value of assets, as investors whose general interest is in the long-term growth of corporate America, we shareholders have confidence in our ability to decide what is best for us, to protect ourselves--if we are given that chance.

Our systems of government and business are so extraordinary and resilient because both are founded on the same democratic ideals. The most basic is full enfranchisement. We should resist any incursions on that principle in the one as we would in the other. We should protect it equally in both. It is the foundation of a compact on which we all have prospered. It is a compact we should not break.

Thank you.

TESTIMONY PREPARED FOR THE RECORD BY

RICHARD A. GRASSO
EXECUTIVE VICE PRESIDENT
NEW YORK STOCK EXCHANGE

BEFORE THE U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

WASHINGTON, D.C.

MARCH 17, 1988

Thank you Mr. Chairman and members of the Committee.

I welcome this opportunity to review the New York Stock Exchange's position on the subject of shareholder voting rights.

The New York Stock Exchange has a long-held tradition and policy of protecting and promoting corporate democracy.

Indeed, many of the corporate practices taken for granted today -- such as the publication of annual and interim reports for shareholders, periodic financial statements and annual shareholder meetings -- are all New York Stock Exchange initiatives.

They are all to the benefit of public investors, and all were put into place prior to the creation of the Securities and Exchange Commission.

The Exchange's history of support for basic shareholder protections is a long and proud one. It's foundation is a commitment to a philosophy of fairness and equity that we have never and will never waver on.

The end result is that the New York stock Exchange has helped develop and promote an extremely high standard of corporate democracy, which, in turn, has helped to expand public ownership and nurture economic growth in America.

The investing public that buys and sells the securities listed on the NYSE knows that each and every investor and potential investor will be treated fairly.

The New York Stock Exchange's long-standing policy that all common stock listed on the Exchange be voting stock not subject to unequal voting rights -- otherwise known as the one share, one vote, standard -- has been an important part of that process.

For more than sixty years, the NYSE alone has applied the standard of one share, one vote as a simple and direct means of assuring shareholders the right to vote on important corporate issues.

At the same time, it's important to recognize that significant changes have occurred in the corporate environment.

The increased role of institutional investors -- in both trading and exercise of voting rights -- and the general improvement in regulatory effectiveness have dramatically altered the climate in which this policy operates.

In addition, many state governments have greatly restructured their approach to shareholder voting rights, moving from a policy of one share, one vote to a more flexible standard. As a result, many state voting rights standards are different from the NYSE standard.

Moreover, economic conditions of the 1960s and '70s created large disparities between the asset value and market value of many companies, resulting in a sharp increase in hostile tender offers by domestic and foreign entities during the 1980s.

In response, a small but growing number of listed companies have asked their shareholders to approve changes in voting rights that would, directly or indirectly, give management greater control.

In some instances, this has involved creating a second class of common stock having multiple votes per share. In several widely publicized cases, shareholders have voted, by large majorities, to approve such proposals. This emerging trend cannot and should not be ignored.

Under our current listing standards, the creation of classes of stock with disparate voting rights, regardless of motive, makes issuers subject to delisting, even though they otherwise remain fully qualified.

In light of these changes in the business and corporate environment, isn't it time for there to be a corresponding adjustment in the area of one share, one vote?

If the answer to that question is no, then it is up to the Federal Government to say so. If, on the other hand, shareholders should be permitted to diminish or forego their right to vote on corporate matters, then we must specify the conditions under which they can alter their franchise.

The position of the NYSE on this issue is simple. The Exchange supports the concept of a uniform rule on voting rights among all stock markets, provided shareholder interests are safeguarded.

We have consistently stated -- and we repeat now -- that the NYSE continues to favor the standard on one share, one vote. But the actions and opinions of our constituents indicate this may no longer be the most practical policy for all the situations they face.

Accordingly, in September 1986, we made a proposal to the SEC to modify our one share, one vote standard. In the absence of a uniform rule imposed by the SEC or Congress, we believed that our proposed rule modification represented a reasonable compromise.

That proposal continued to maintain the principle of shareholder democracy in that it provided that no action altering shareholder rights could be taken without the approval of those who would be affected.

Our decision to modify our long-standing one share, one vote rule was not a decision we arrived at lightly.

In June 1984, our Board of Directors appointed a special advisory committee on Shareholder Participation and Qualitative Listing Standards. Its mission was to prepare recommendations to the Public Policy Committee of the Board with respect to listing standards relating to shareholder voting requirements, recognizing the realities of a changing environment.

The special committee solicited comments from over 3,000 Exchange constituents and received some 400 responses, primarily from the corporate community. Based on those comments and an extensive examination of the issue by the special committee and the Board, the Exchange filed a proposal with the Commission in September 1986 to modify its voting rights policy.

The key element in the proposal is the approval procedure for any variation from the historical one share, one vote policy. We would require the approval of a majority of the independent directors and a majority of the shares owned by public shareholders eligible to vote. Management would stand free of the voting on such an issue. Shares owned by corporate officers and directors, members of their immediate families or their affiliates, or affiliates of the issuer would be excluded from the approval process.

It should be emphasized that the proposal will require approval by a majority of shares owned by public shareholders eligible to vote, not merely a majority of those actually voted. Since shares not voted have the same effect as negative votes, a change cannot be approved as a result of low participation or the action of a small quorum.

The Commission has decided not to act on our proposed rule modification, and instead has proposed rule 19c-4 in its place. That rule would prohibit the listing, or continued listing, of companies that issue stock or take other corporate action that would nullify, restrict or disparately reduce rights of existing common shareholders. The SEC proposal included a May 15, 1987 grandfather date but didn't include other exemptions from the prohibition. Instead, the proposed rule authorized each self-regulatory organization to specify, subject to approval by the SEC, any securities or corporate action that would be excluded from the rule. The SEC held a public hearing in 1987, but has taken no further action.

At that hearing, the Exchange supported the proposed rule but expressed reservations about permitting each individual market, even with SEC approval, to draw up its own list of exemptions from the rule. We believe that a combination of the rule proposed by the Commission and the modifications we have proposed provide an even better alternative.

The approval of public shareholders and independent directors was the foundation of our proposal. We believe it's a worthwhile provision of any standard short of maintaining a uniform one share, one vote requirement across all markets.

The Exchange believes the time has come for uniformity, and the SEC's initiative -- with our suggested amendments -- would achieve that objective.

But in adopting a uniform standard, we should not overlook the possibility of corporations turning to domestic or non-U.S. trading mechanisms not under the jurisdiction of the SEC.

More specifically, there must be safeguards to prevent an inter-dealer quotation system from being developed that would provide a refuge for companies that want to escape from a uniform standard.

We must also preclude a market from developing outside the U.S. in which stock in companies that have been delisted would be traded.

And finally, there is the need for precision in any rule that is adopted. Case by case application of broad guidelines will only lead to the opportunity for interpretative arbitrage by the self-regulatory organizations.

Having said that, we would support adoption of the SEC's rule 19c-4 provided it requires the approval of both a majority of the independent directors and a majority of those public shares eligible to vote prior to any action altering shareholder rights.

Finally, let me add that the voting rights issue is one of those on which uniformity across all markets can be achieved by legislative action at the national level.

All parties acknowledge the leading role that the states play in corporate law and regulation.

The CHAIRMAN. Thank you very much, Mr. Grasso.

Our next witness is Robert Monks, president of the Institutional Shareholder Services. Mr. Monks has been introduced by Senator Heinz already. Go right ahead.

STATEMENT OF ROBERT A.G. MONKS, PRESIDENT, INSTITUTIONAL SHAREHOLDER SERVICES, INC.

Mr. MONKS. Thank you very much, Mr. Chairman.

Mr. Chairman, as a personal matter, I would like simply to take this occasion after over 10 years of running and eating vegetables to thank you for the work that you have done in authoring books on health and exercise and I appreciate it very much.

The CHAIRMAN. Well, you look in great shape, much better than I do.

Mr. MONKS. We'll see how I am after the hearing. [Laughter.]

Mr. Chairman, I ask the chair's consent to enter into the record my prepared testimony. Quite frankly, it's quite long and quite a bit of the material has been covered rather better than I did, I'm sorry to say, by Senator Armstrong.

The CHAIRMAN. Without objection, it will be entered in the record.

Mr. MONKS. I would like, therefore, simply to make a few direct oral comments.

Mr. Chairman, respectfully, the buck stops here. One share/one vote is in trouble. This essential component of the accountability of private power in the United States has been federally assured for over 50 years through the SEC's oversight of the New York Stock Exchange. As we've heard extremely well stated, the Stock Exchange can no longer be expected alone to carry the entire load of assuring appropriate governance over corporate power.

The Supreme Court of the United States and State legislatures have created and are creating confusion and management entrenchment. The SEC needs legislative direction and support. To put it as simply as I can, failure of the Congress to affirm one share/one vote will repudiate successful Federal involvement.

Let there be no confusion. The issue here is Federal retreat, not preemption.

Power, Mr. Chairman, has been the source of concern for Americans since the foundation of the Republic, whether it is the power of government or the power of private entities. The constitutionally mandated separation of power between branches of government is a successful precedent for comparable need for balancing power in the private sector. Whenever in this country's history we have permitted the perpetuation of corporate power through any legal device to disenfranchise owners, excesses and disasters have predictably followed.

Mr. Chairman, in my prepared testimony I recount the vast deliberations of this body in the early 1930's before the enactment of the Investment Company Act of 1940 and the Public Utility Holding Company Act of 1935, which responded to the disasters of those times, by outlawing for those categories of companies flatly other than one share/one vote.

Mr. Chairman, I'd like to comment briefly and I will in this instance read from my prepared comment on page 6. The additional views of Senators Sasser, Sanford, and Chafee appearing at page 87 of your Senate document 100–265 referred to "It is the shareholders after full disclosure who determine voting rights within their corporation."

This statement presented as part of a concurring Senate committee report, unfortunately, confuses tradition and theory with the practical reality. It must be recognized, Mr. Chairman, that the existing state of corporate democracy makes those two words the classic oxymoron.

The statement from the committee report is inapplicable for two reasons. First, shareholders are structurally prevented from determining anything through the proxy system. Quote from Edward J. Epstein's recent book: "Who Owns the Corporation": "Since they offer the voter no real choice, these elections are democratic only in a very limited sense. They are procedurally much more akin to the elections held by the Communist party of North Korea than those held in Western democracies."

Management controls the ballot and counts the votes. Inefficiency, corruption and agency costs, an economic concept, prevent the beneficial owners from having any say in how their shares are voted. Those who reiterate the absolutely essential element in corporate governance that some majority of shareholders approve a particular action do not recognize that shareholdings in thousands of companies dispersed among tens of millions of individuals tend to be too fragmented to organize around any kind of election campaign.

Shareholder approval, Mr. Chairman, under present circumstances, is meaningless.

What will occur if the Congress fails to retain one share/one vote? I respectfully submit the following. State legislatures will continue to proliferate control share statutes, increasingly inconsistent and increasingly confused.

For example, Mr. Chairman, I find that I will be on Monday in my own State of Maine, at the instance of the only one of the Fortune 500 presently incorporated there, to deal with yet a further refinement on the CTS clone phenomenon.

The Securities and Exchange Commission will not be able to expand its one share/one vote standards to the American Exchange and the Over-the-Counter market simply, Mr. Chairman, because it's out of their salary range. So long as the subject is under consideration in this body which is the prime authority in the United States, no appointed official is going to feel comfortable in taking a position on the subject.

The Supreme Court will be confronted with increasingly oppressive post-CTS antitakeover laws. Most importantly, the rather fragile existing climate encouraging accountability to shareholders will perish. I call it a fragile climate, Mr. Chairman, because one searches in vain for instances where dissident shareholders have been able successfully to challenge management proposals.

Our Nation's wealth and resources will end up in the hands of self-perpetuating private bureaucracies.

Mr. Chairman, in conclusion, the Federal position has been correct and it needs to be sustained. One share/one vote is the ultimate guardian of a system that provides for the best possible combination of resources. If the issue is presented fairly to shareholders, they will endorse that view; but allowing management to present it as a coercive exchange offer is unfair, uneconomic and undemocratic.

Thank you, Mr. Chairman.

[Additional statement of Senator Sanford on his remarks made in the Senate Report 100-265 and the complete prepared statement of Robert A.G. Monks follow:]

ADDITIONAL STATEMENT OF SENATOR SANFORD
HEARING ON ONE-SHARE/ONE-VOTE
(TO FOLLOW TESTIMONY OF ROBERT MONKS)

IN HIS TESTIMONY, ROBERT MONKS IS CRITICAL OF THE ADDITIONAL VIEWS THAT I SUBMITTED ALONG WITH MY COLLEAGUES JIM SASSER AND JOHN CHAFEE IN CONJUNCTION WITH THE COMMITTEE REPORT ON S. 1323, THE TENDER OFFER DISCLOSURE AND FAIRNESS ACT OF 1987. BECAUSE MR. MONKS' TESTIMONY REFLECTS SUCH A MISUNDERSTANDING OF THOSE VIEWS AND BECAUSE HIS TESTIMONY CONTAINS SO MANY INTERNAL INCONSISTENCIES AND MISSTATEMENTS REGARDING A "FEDERAL CORPORATE LAW" REGARDING ONE SHARE/ONE VOTE, I AM SUBMITTING THAT PORTION OF OUR VIEWS THAT ADDRESSES THE ONE-SHARE/ONE-VOTE ISSUE IN ORDER TO CLARIFY THE RECORD.

THE MAIN POINT MADE IN THESE ADDITIONAL VIEWS IS THAT A FEDERAL MANDATE FOR ONE-SHARE/ONE-VOTE IS A PREEMPTION OF THE RIGHT OF THE STATE TO DETERMINE THE VOTING RIGHTS OF CORPORATIONS AND WOULD ACT TO OVERTURN THE CTS DECISION OF THE SUPREME COURT. THE VIEWS MAKE IT CLEAR THAT DISPARATE VOTING RIGHTS HAVE OFTEN BEEN USED TO BENEFIT SHAREHOLDERS, NOT TO HARM THEM, AND THAT SHAREHOLDERS WHO PURCHASE SHARES WITH DISPARATE VOTING RIGHTS DO SO WITH FULL KNOWLEDGE OF THE VOTING RIGHTS CARRIED BY THOSE SHARES.

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Report
100-265

TENDER OFFER DISCLOSURE AND FAIRNESS ACT OF 1987

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 1323

together with

SUPPLEMENTAL AND ADDITIONAL VIEWS

December 17 (legislative day, December 15), 1987.—Ordered to be printed

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C. BACKDOOR PREEMPTION: ONE SHARE/ONE VOTE

At the mark-up of S. 1323, proponents of state preemption offered an amendment to the bill establishing a one share/one vote rule for all public companies. We believe such a proposal would essentially preempt state laws, is antidemocratic, and limits corporate financing methods.

The one-share/one-vote proposal can be seen as a backdoor method of preempting various state laws and most probably an attempt to overturn the recent Supreme Court decision in *CTS*. Justice Powell, writing for the majority in *CTS*, asserted that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, *including the authority to define the voting rights of shareholders.*" (Emphasis added.)[62] Almost all state corporation laws permit shareholders to adopt capital structures under which some shares or classes of shares, with full disclosure, have greater voting rights than others. Thus, proposals that directly or indirectly forbid any corporation from having shares with different voting rights conflict with almost all state corporation laws, and could prevent corporations from utilizing state laws or accepted corporate measures to protect against abusive takeovers.

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[62] *Id.* at 1649.

For example, the Indiana Act at issue in *CTS* prevents an acquiring person from voting a control block of stock unless disinterested shareholders have granted approval for the voting rights. Because the acquiring person and management are initially disenfranchised, the one-share/one-vote requirement would invalidate the Indiana law and also the fourteen state laws modeled on it. The one-share/one-vote proposals also could be interpreted as preempting statutes such as New York's or Minnesota's that require, at certain times and under certain conditions, approvals of a supermajority of shareholders (*e.g.,* 80 percent shareholder approval) or a majority if disinterested shareholders.

The proposals would also prohibit shareholders from including protective measures in corporate characters such as requirements that certain actions, such as "squeeze-out" mergers, be taken only after approval by a supermajority vote of the shareholders or by a majority of disinterested shareholders. Shareholders' rights plan—so called "poison pills"—would also be placed under a cloud, since these plans protect shareholders by permitting them to acquire shares and, thus, voting rights, on more favorable terms than those available to a raider.

Apart for its intrusion on state law, federal imposition of a one-share/one-vote standard is antidemocratic. It is the shareholders, after full disclosure, who determines voting rights within their corporation. Neither the board of directors nor management can change these rights without shareholder approval. Any legislative or regulatory prohibition of different voting rights adopted by shareholders serves to reduce the say of shareholders. Under a federal one-share/one-vote requirement, even if the majority of all shareholders vote in favor of a capitalizaiton with different voting rights, such capitalization would be prohibited. We believe that it is odd to advocate corporate democracy by denying shareholders the franchise to vote as they wish.

In addition, the one-share/one-vote proposal conflicts with free market principles by restricting innovative capital structures and financing by corporations. Stock with disparate voting rights is a traditional financing tool with many legitimate uses. For example, several corporations adopted creative capital structures to accommodate complex acquisitions—General Motors-EDS and Chemical Bank-Texas Commerce, for example—contrary to a now suspended New York Stock Exchange policy is not shared by other exchanges or the National Association of Securities Dealers ("NASD"). The frequency with which companies use such stock reflects its utility. In addition, certain traditional kinds of securities—preferred stock, convertible debt, shareholder rights plans, etc.—all have the effect of disparately reducing existing voting rights. The ability to issue all these securities benefits the corporation and its shareholders.

A one-share/one-vote requirement also would discourage family-controlled companies from raising capital in the public markets because of the risk of loss of control. Family controlled companies often have a "dual class capitalization" which usually involves two classes of common stock—"A" stock and "B" stock. The A stock is usually held by the public and has one vote for share. Often, the A stock pays a higher dividend than the B stock. This type of capital structure allows a family-owned business to obtain financing through the issuance of common stock without relinquishing control. Some of our most successful corporations have dual class capitalization—The Dow Jones Company, The New York Times Corporation, The Washington Post Company and Wang Laboratories. Investors have not been deterred from investing in these very profitable companies by their dual class structure.

Many proponents of hostile takeovers began to advocate one-share/one-vote proposals only when shareholders of some corporations acting under state law began to adopt voting rights provisions that would make the corporation less vulnerable to a takeover or to manipulative activities.

In addition to dual capitalizations described above, shareholders have used other types of corporate structures with varied voting rights. For example, "capped voting" limits the votes that any one shareholder may cast (without shareholder or other approvals) to a specified percentage of the outstanding shares of common stock—usually 10 percent to 15 percent. Almost identical in purpose and operation to state control share acquisition laws (like Indiana's) capped voting provisions ensure that all shareholders have an effective vote, not just the large shareholder; for example, without capped-voting, minority shareholders are effectively completely disenfranchised once a corporate raider acquires a majority of the voting shares. MCI Corporation and Carter Hawley Hale are two of several companies with capped voting.

"Phased voting rights" permit shareholders who have held their shares for a longer period of time to cast a greater number of votes. This encourages both long term investment in the corporation and a long term management perspective. It does so by permitting management the opportunity to carry out long-range plans without apprehension that raiders will take advantage of short term stock declines due to heavy capital investment, large R&D programs, etc. Cincinnati Milacron and Carlisle Corp. are examples of phased voting.

In sum, we believe that proponents of hostile takeovers may be advocating one-share/one-vote because they do not believe that shareholders should have the right to reduce their company's vulnerability to a takeover. However, this could well result in significant costs: the preemption of the state role, as well as a restriction of shareholder rights and corporate financing flexibility. The proposal on its face suggests that it will insure corporate democracy, but a federal one-share/one-vote requirement is, in our opinion, not a positive step for corporations, shareholder democracy, and the economy.

IV. CONCLUSION

The economic evidence that we have examined indicates that corporate raiders and their allies have exploited loopholes in the Williams Act to promote their private gain at the expense of the nation's economy, corporations, shareholders, employees, and communities. Their attacks on many of America's leading companies have left the companies severely weakened at a time of rising concern regarding the competitiveness of American business. This bill addresses many of the deficiencies in the Williams Act that raiders have exploited. We support this effort to curb these abuses. We also strongly support the efforts of state governments that have amended their corporation laws to provide shareholders with greater protection against inadequate or coercive tender offers and against abusive defensive practices of management. We write to express our belief that this legislation must be strengthened to reaffirm explicitly the longstanding role of the states in regulating matters of corporate governance.

JIM SASSER.
TERRY SANFORD.
JOHN CHAFEE.

But in areas where federal action is permissible and especially where simplicity and efficiency are important considerations, a uniform standard for the entire country is often most desirable.

Uniformity can facilitate operations and make domestic markets more competitive, as well as position the U.S. to play an effective and influential role in establishing parameters for the evolving global marketplace.

So in the interest of uniformity, if shareholders are to be prohibited from giving away their voting rights, it's incumbent upon the Federal government to mandate a strict one share, one vote standard across all markets.

In the absence of such a standard, we believe that we've offered an alternative proposal that reflects the changing nature of today's corporate and business environment. And that does so in a way that's sensitive to and consistent with basic shareholder protections.

Throughout its history, the New York Stock Exchange has been a vocal and effective advocate of shareholder rights. We remain true t that tradition. At the same time, we recognize that attitudes toward shareholder voting rights have changed and that there is a need for flexibility on the issue.

Accordingly, we look forward to working with the Congress. this Committee, the SEC and all other interested parties to resolve this issue in a way that reflects both these changing attitudes and the necessity for flexibility consistent with protecting the interests of all public shareholders now and in the future.

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The **Chairman**. Thank you, Mr. Monks.

Dr. Ruback is a professor at the Harvard Business School. Go right ahead, sir.

Mr. **Ruback**. Thank you for the promotion. I'm a visiting associate there, but I like the promotion and I'll take it.

STATEMENT OF RICHARD RUBACK, VISITING ASSOCIATE PROFESSOR OF FINANCE, HARVARD BUSINESS SCHOOL

Mr. **Ruback**. I'm just going to summarize my prepared statement and ask that that be included in the record.

The **Chairman**. It will be printed in full in the record, sir.

Mr. **Ruback**. My opinion is that incumbent managers can use their agenda setting powers to coerce stockholders to surrender their voting rights without adequate compensation.

Like Senator Armstrong, I have no objection to dual class equity structures per se. Instead, my concern is with the method used to transform a single class of equity into a dual class structure. I believe that shareholders should be protected from coercion during this transformation.

SAFEGUARDS

Like Senator Proxmire, when I first began research on this topic, my initial reaction was that regulatory intervention was not required. Shareholders had, after all, two important safeguards to protect them. First, shareholders must approve the recapitalization plan; and second, the decision to exchange their ordinary shares for limited voting shares is purely voluntary.

My review of research on the proxy process indicates that this first safeguard—the stockholder vote on the proposal—may not offer protection.

My research specifically focuses on this second safeguard. That research indicates that voluntary exchange does not in fact protect shareholders. The terms of the dual class recapitalization can be structured to compel individual outside shareholders to exchange their shares for limited voting shares even though the same shareholders in the same circumstances but acting collectively would choose not to do so.

In my research I develop a model to trace the impact of recapitalization on share prices. In the analysis, shareholders are given the opportunity to trade their shares for limited voting shares with higher dividends. This choice presents outside shareholders with a classic prisoner's dilemma.

It exploits the inability of individual shareholders to act together. Each shareholder's rational choice leads to an outcome that is worse than if all shareholders retain their original shares. This occurs because small shareholders generally ignore the impact of their exchange decision on the probability of receiving a takeover bid.

The recapitalization plans I examine entice outside shareholders with higher dividends. Examples of this type of plan include Wang Laboratories, Hershey, among others. If all shareholders received the higher dividends, no change in value would result. The dividends would simply be financed by reducing investments that just-break even. But the plan provides the opportunity for wealth transfers between shareholders. Shareholders that get the higher dividends receive a subsidy from shareholders that retain their original shares. This provides an inducement to exchange.

The perceived costs to the individual shareholders from exchanging depend on the rules for dividing the gains from takeovers across the different classes of common stock. These rules are, of course, uncertain. But an interesting result of my research is that as more of the potential benefits are assigned to the limited voting class shares, the more effective is the coercion.

For example, suppose the rule required that in the event of a takeover limited voting stock would receive twice the per share takeover premium that ordinary common stock received. To a small outside shareholder, such a rule would mean that there was a double benefit to taking limited voting shares: higher dividends and higher takeover benefits. But both of these benefits are illusions. The higher dividends come from reduced investment. And the higher takeover benefits never occur, as managers use their veto power to reject all hostile takeover bids.

While I focus on plans that use higher dividends to induce outside shareholders to choose limited voting class stock, there are other devices that are also at least as coercive. For example, the chairman mentioned Dow Jones, who dramatically restricts the trading of its shares with superior voting rights. Shares automatically convert to limited voting stock when sold in an arms length transaction. This lack of marketability of the superior voting Dow Jones stock makes that plan at least as coercive as the dividend plans I examine.

The losses from recapitalization evolve eliminating the external market for corporate control. The potential takeover premiums disappear and the firm is less efficient as managers enjoy the benefits of being insulated from takeovers. To complete a hostile takeover attempt, a bidding firm has to either replace the target's board of directors or has to merge with the target. Both of these avenues are foreclosed by dual-class plans.

For example, a hostile bidding firm that purchased all of the outside shares would not be able to gain control over a target after a recapitalization plan. Therefore, dual class plans may be the most effective universal antitakeover device ever invented. They give managers that do not own a majority of the stock complete veto power over hostile bids.

Dual class exchange offers can be coercive because managers set the terms and conditions for the exchange and provide an inducement to exchange. This presents shareholders with a distorted choice that can reduce the value of their claims. Nevertheless, dual-class shares can provide flexibility. To achieve a dual-class capitalization without coercion, it may be possible to use the capital market to set the terms of the exchange.

Nonvoting shares can be issued in an initial public offering and the proceeds can be used to repurchase the voting shares. This method still results in the loss of the expected takeover premium, but it forces managers to repurchase those control rights at fair market value using their own money, something not true of exchange offers.

This approach is similar to the rule proposed by the Securities and Exchange Commission. The SEC rule would prevent firms from issuing securities or taking other actions that reduce the per share voting rights of common stockholders.

I support this proposal. It prevents managers from using their agenda setting powers to reduce the value of the outside shareholders' claims. It also preserves flexibility, allowing firms the opportunity to issue common stock with inferior voting rights.

In summary, the change from a single class of equity to a dual-class equity structure can coerce shareholders. Some plan, such as the SEC proposal, should be adopted to prevent coercion in these circumstances.

Thank you.

[The complete prepared statement of Richard S. Rubick follows:]

TESTIMONY OF ROBERT A.G. MONKS

PRESIDENT, INSTITUTIONAL SHAREHOLDER SERVICES, INC.

BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

March 17, 1988

> "This policy of supplying by opposite and rival interests, the defect of better motives, might be traced through the whole system of human affairs, private as well as public. We see it particularly displayed in all the subordinate distributions of power; where the constant aim is to divide and arrange the several offices in such a manner as that each may be a check on the other; that the private interest of every individual, may be a centinel over the public rights. These inventions of prudence cannot be less requisite in the distribution of the supreme power of the state." Federalist Papers # 51

Mr. Chairman and Members of the Committee, I am grateful for the opportunity to appear before you today to discuss this important issue. I would like to begin by correcting one important misunderstanding about the one share, one vote rule. It has been referred to by some commentators on this bill as a new requirement, imposed for the first time, and pre-empting state laws. On the contrary, Federal law for the past sixty years has provided that one share, one vote is a requirement for corporations listed on the New York Stock Exchange ("NYSE"). This is the law today. The only question is whether the Federal government will retain those standards, standards that have effectively been enforced pursuant to Federal authority since before the stock market crash of 1929.[1]

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[1] The NYSE is a Self Regulatory Organization under the authority of the Securities & Exchange Commission ("SEC"). This means that the NYSE is free to develop its own rules of procedure, unless such are disapproved by the SEC. The NYSE notified the SEC of its desire to change one share/one vote late in 1985. The SEC held unprecedented public Hearings in December 1986 and has, as yet, declined to approve the requested change. All companies that have elected dual class recapitalizations in the meantime are in a "limbo" category, continuing to be listed on the Exchange, pending final determination of the matter.

The pressure to rescind the rule comes from companies who want to prevent takeovers by essentially taking their companies private without having to pay the full price. Chairman Phelan of the NYSE described the problem in testimony before Congress in July of last year: "In response to hostile takeovers, a small but growing number of listed companies have asked their shareholders to approve changes in voting rights that would, directly or indirectly, give management greater control. In some instances, this has involved creating a second class of common stock having multiple votes per share...We have consistently stated--and we repeat now--that the NYSE continues to favor the standard which we alone applied over the past sixty years: the standard of 'one share, one vote'."[2] The NYSE's problem is that dual class capitalization, traditionally limited to a very few, mostly family-run, companies, has all of a sudden become an easy way to protect management from hostile takeovers, and permitting the trading of dual class shares has made some of the NYSE-listed companies consider moving to the other exchanges. It has proven impossible for the Exchanges to agree on a common policy, notwithstanding the efforts of the SEC to promote such a result.

Even if the proposed SEC rule does become final, its impact will not be clear. The decision of the U.S. Supreme Court in April, 1987 in CTS[3] raises the question as to whether Indiana companies taking advantage of their anti-takeover statute would risk having their shares delisted by the NYSE.

The pressures of hostile takeovers have forced the question through the NYSE, the SEC and the Supreme Court to require, as a practical matter, that the Congress decide whether it wants to change what has been for sixty years one of the cornerstones of Federal Corporate Law.

Our testimony[4] presents three arguments for enactment of a Federal requirement assuring one share, one vote. First, it is essential that power in a democracy be meaningfully accountable to somebody and that those who bear the ultimate risk of profit or loss in the corporate structure should have the authority and the responsibility of voting control; second, the existing corporate voting process is dysfunctional, recapitalization into two voting classes is coercive and dual classification is irreversible; and third, competitive pressures have vitiated the capacity of both state law and the New York Stock Exchange to do what has to be done. In extremis, Federal involvement is necessary.

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[2] Testimony of John J. Phelan, Jr., Hearings before Subcommittee on Telecommunications and Finance of the Committee on Energy and Commerce of the House of Representatives, One Hundredth Congress, First Session on H.R. 2172 (Serial No. 100-65), July 29, 1987 at p.538, 543,544.

[3] 107 S.Ct. 1637 (1987).

[4] Attached to and made a part of this testimony is the written material submitted by Institutional Shareholders Services, Inc. to the Securities & Exchange Commission on December 16 & 17, 1986, including statements by Nell Minow, Richard S. Ruback, John Pound, and Robert A.G. Monks.

Background

"One Share/ One Vote" has played a colorful and dramatic role in American financial history. On October 28, 1925, William Z. Ripley, a Harvard University professor of political economy warned: "[T]he new stock, thus sold, is entirely bereft of any voting powers, except in case of actual or impending bankruptcy. General stockholders, to be sure, have always been inert, delegating most of their powers of election. But at worst they might always be stimulated to assist themselves, and, in any event, they all fared alike as respects profits or losses." Ripley's drawing attention to then current abuses touched off a literal fire storm in the public consciousness and one share, one vote became standard capitalization for the most prominent American industrial companies.

The regulatory framework governing the issuance and trading of public securities and the functioning of exchanges was almost entirely set up by two landmark statutes of the New Deal era. Congress passed the 1933 Securities Act and 1934 Securities and Exchange Act after exhaustive debate and in response to overwhelming evidence of mismanagement, deception and outright fraud during the stock market boom of the late twenties. In the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940, multiple classes of common stock with differing voting characteristics were flatly prohibited for the affected companies. Rather than attempt with industrial companies to remedy specific mistakes or abuses, lawmakers attempted a far more difficult task; they tried to set up a process of corporate accountability--an impartial set of rules preserving the widest possible latitude for shareholders to protect their financial interests. In searching for a reliable and familiar model, they turned to America's own traditions of political accountability. Shareholders were seen as voters, boards of directors as elected representatives, proxy solicitations as election campaigns, corporate charters and by-laws as constitutions and amendments. Just as political democracy acted to guarantee the legitimacy of governmental or public power, the theory went, so corporate democracy would control--and therefore legitimate--the otherwise uncontrollable growth of power in the hands of private individuals. Underpinning that corporate democracy, as universal franchise underpinned its political counterpart, was the principle of one share, one vote.

The one share, one vote standard was carefully adopted by the Federal government in the face of unignorable evidence of the evils of pyramiding and otherwise separating management from the need to account to ownership. Its application to industrial companies through the NYSE listing requirements has until recent changes in competitive conditions been an efficient procedure.

Need for Shareholder Accountability

Throughout American industrial history, public disaster has predictably followed any trend to remove managements from accountability to shareholders. For example, disastrous experience in the 1920's with public utility companies and investment companies who consolidated control in a few voting shares, held by managers, led to the enactment of legislation to impose the one share, one vote rule on those companies.[5] The Public Utility Holding Company Act was a response to a 78 volume report prepared by the Federal Trade Commission ("FTC") (S. Doc. No. 92, 70th Cong., 1st Sess., pt. 72-A et. seq. (1935)). In the report, the FTC noted:

> Instead of the corporation on one side and the public, on whom it will depend for trade and revenue, on the other, as was the case originally, we have a third party of minority ownership but with management and control which may be likened to absentee landlordism. Obviously, whenever this managerial group becomes swayed with lust for power and greed for excessive profits, the many other stockholders are treated as having few, if any, rights. In many instances, such managerial groups have failed to act as trustees for their corporations and other stockholders, as in equity they are supposed to do. (*Id*. 73-A at 64)

The Investment Company Act is also especially relevant here. The legislative history shows that it was enacted in response to three factors: the large proportion of investors involved (one out of 10 investors was a participant in an investment company, according to the SEC staff report to Congress), the serious discrepancy between equity interest and voting rights, and the consequent conflicts of interests between the senior and junior shareholders. The SEC found that multiple classes of stock with divergent voting rights were a major factor in the corruption and abuse prevalent in the investment industry in the 1940s. Section 18 of the Act, applying one share, one vote to investment companies, was adopted in response. Management must be made accountable to shareholders who can vote them out.[6] Last year, Arthur Levitt, Chairman of the American Stock Exchange, noted:

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[5] Public Utility Holding Company Act of 1935 (15 U.S.C. Secs. 799-79z-6) and Investment Company Act of 1940 (15 U.S.C. Secs. 80a-1-54).

> One of the historical sources of the New York Stock Exchange rule against non-voting stock lay in the use of such shares in the public utility industry in the 1920's: non-voting stock was a key device that underlay the pyramiding of personal control in that industry and that ultimately led to collapse, to a tragic loss of public confidence in our capital markets, and to direct Federal regulation in the form of the Public Utility Holding Company Act. Hearings before the Subcommittee on Securities, *supra*, at 1171.

Corporate efficiency and legitimacy depends on the managers who are, in effect, the agents of shareholder-principals. To the extent that the "agency costs" of managers increase, productivity and innovation will decline. In an important analysis published in the Journal of Law and Economics, for example, Frank Easterbrook and Daniel Fischel argued that the separation of residual claims from voting power will always create agency costs which contribute to substantial inefficiencies in corporate oversight. They found that the one share, one vote rule ensures that no unnecessary agency costs will be created.[7]

As the shareholder loses even the theoretical ability to control corporations by holding their managers to account, those corporations will cease to pay attention to the need to maximize profits. They will become bloated and inefficient, causing dislocation in supply and demand, and performance will drop. Furthermore, if managers cannot be held responsible for meeting clear, public standards of performance such as profits, sales or growth, then their focus of attention will shift from outside to inside the corporation. Managers will place a higher value on maintaining good relations with employees, suppliers or local communities than on increasing market share through improved products or services. The inevitable goal of the corporation will become self-perpetuation, the inevitable result will be a stifling level of bureaucracy.

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[6] The NYSE's adoption of the one share, one vote rule was influenced by *Main Street and Wall Street*, by W. Ripley. In his book he described particularly outrageous examples of abusive practices. In one, Industrial Rayon issued 600,000 shares of common stock. Only 2,000 carried voting rights.

[7] Easterbrook, Frank H. and Daniel R. Fischel, *Voting in Corporate Law*, XXVI Journal of Law and Economics 395, 410-11.

This is not all, however. Once it becomes readily apparent that the mechanisms of corporate control are illusory--then the rationale for state and Federal governments not intervening in the private sphere will disappear. Governmental interference and regulation will be seen as the natural alternative, with exponentially greater agency costs and predictably disastrous results. American corporate capitalism will come to resemble European corporate socialism.

Voting Deficiencies

"It is the shareholders after full disclosure, who determine voting rights within their corporation."[8] This sentiment, presented as part of a concurring Senate Committee report, unfortunately confuses tradition and theory with the practical reality. It must be recognized that the existing state of corporate democracy makes those two words the classic oxymoron.

The statement from the Committee report is inapplicable here for two reasons. First, shareholders are structurally prevented from "determining" anything through the proxy system. "Since they offer the voter no real choice, these elections are "democratic" only in a very limited sense. They are procedurally much more akin to the elections held by the Communist Party of North Korea than those held in Western Democracies."[9] Management controls the ballot and counts the votes. Inefficiency, corruption, and, again, agency costs, prevent the beneficial owners from having any say in how their shares are voted.[10] Those who reiterate the absolutely essential element in corporate governance that some majority of shareholders approve a particular action, do not recognize that "shareholdings in thousands of companies, dispersed among tens of millions of individuals, tend to be too fragmented to organize around any kind of election campaign."[11] Shareholder approval under present circumstances is meaningless.

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[8] Additional Views of Senators Sasser, Sanford, and Chafee, Report of the Committee on Banking, Housing and Urban Affairs, Unites States Senate to accompany S. 1323 (December 17, 1987), at p. 87.

[9] Epstein, Edward J., Who Owns the Corporation, Twentieth Century Fund, 1986, at p. 13.

[10] See Conflicts of Interest in the Proxy Voting System, James E. Heard and Howard D. Sherman, Investor Responsibility Research Center.

The process by which shareholders are presented with a proposal for recapitalization into dual classes of voting stock is inherently coercive. Apparent efforts to provide equal value for each choice backfire, in fact, increasing the coercive character of the recapitalizations. Easterbrook and Fischel said, in discussing the possibility of a market in votes, "The collective choice problem would exert a strong influence over the market price of votes. Because no voter expects to influence the outcome of the election, he would sell the vote (which to him is unimportant) for less than the expected dilution of his equity interest. He would reason that if he did not sell, others would; he would then lose on the equity side but get nothing for the vote...Thus, the legal rules tying votes to shares increase the efficiency of corporate organization." By enacting provisions which skew the voting power of different classes of stock and thereby protecting directors and officers from removal, management tends to make itself self-perpetuating at the expense of shareholders.

Giving any shareholders the opportunity to dilute or relinquish their votes puts them on the horns of a dilemma. Massachusetts Institute of Technology professor Richard Ruback has demonstrated that "The terms of the dual class recapitalization can be structured to compel individual outside shareholders to exchange even though the outside shareholders, acting collectively, would choose not to exchange...(so that) the rational choices by individual outside shareholders leads to an outcome that harms the outside shareholders" as a group. (Emphasis in original.) In other words, when the issue of limited voting rights is presented to shareholders, a rational, fiscally optimal choice made by an individual may, when made by enough individuals to carry the resolution, result in significant reduction in value of the holdings of all of them.

Need for Federal Action

We share the concerns of the Committee about Federal preemption of matters traditionally left to the states. But one share, one vote has traditionally been an NYSE listing standard, imposed at the Federal level through the SEC's approval of standards issued by a self regulatory organization. As was apparent throughout its testimony to the SEC in December 1986,

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[11] Ibid., at p. 43.

the NYSE submitted its proposed change despite its own finding that the one share, one vote rule is "good for its listed companies, good for their shareholders, and good for this country...has served the market well, [and]...[i]n an ideal world, most people would want it to be retained."[12] The NYSE has found, however, that it can no longer be the sole standard bearer, as major companies threatened defection to the other Exchanges, unless the rule was rescinded.

The recent opinion of the U.S. Supreme Court in CTS v. Dynamics Corporation of America[13] calls into question the status of the one share, one vote doctrine and whether the standard can continue without explicit statutory authorization.

The current situation is chaotic. Private, state, and regulatory action have been proven incapable of resolving it. This is just that rare situation that justifies Federal involvement. One share, one vote is a seminal concept--a notion that is central to the legitimacy of private power in the United States. It is appropriate for the Federal government to establish one share, one vote as an indispensible characteristic of corporate existence in the United States. It is analogous to the fundamental liberties guaranteed to citizens under the Bill of Rights to the Federal Constitution.

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[12] Testimony of the New York Stock Exchange to the Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce, United States House of Representatives, May 22, 1985; see also testimony before the Securities Subcommittee of the Committee on Banking, Housing and Urban Affairs, United States Senate, June 12, 1985).

Apparently, even in the real world, most people want it to be retained. Careful reading of the NYSE's submission to the SEC shows that the 86 percent favorable rating it cites for listed companies is only the percentage of those responding who were in favor of changing the rule. In fact, only 13 percent of the 3224 Exchange constituents and other interested parties surveyed on this issue responded at all, suggesting little interest in changing the rule. Only 249 (less than 8 percent) of all of those surveyed responded in favor of the change. (Submission of the NYSE, File No. SR-NYSE 86-17, Exhibit B.)

[13] See note #3, supra.

Statement by Richard S. Ruback
At Hearings on March 17, 1988
Of the U.S. Committee on Banking,
Housing and Urban Affairs
Washington, D. C.

I. Overview

I am a Visiting Associate Professor of Finance at the Harvard Business School. This statement is based on my recently completed study of Dual-Class Exchange Offers that is forthcoming in the Journal of Financial Economics[1]. I have also testified on the One Share, One Vote issue before the Securities and Exchange Commission on December 16, 1986 and on July 22, 1987.

My opinion is that incumbent managers can use their agenda setting powers to coerce stockholders to surrender their voting rights without adequate compensation. I have no objection to dual-class equity structures, *per se*. Instead, my concern is with the method used to transform a single class of equity into a dual-class structure. I believe that shareholders should be protected from coercion during this transformation.

When I first began research on this topic, my initial reaction was that regulatory intervention was not required because shareholders had two important safeguards to protect them. First, shareholders must approve the recapitalization plan. Second, the decision to exchange their ordinary shares for limited voting shares -- i.e., shares with inferior voting rights -- is voluntary.

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[1] Richard S. Ruback, Coercive Dual Class Exchange Offers, Journal of Financial Economics, 20, (forthcoming 1988)

My review of research on the proxy process indicates that this first safeguard -- the stockholder vote on the proposal -- may not offer protection. Managers can use their agenda setting powers to force shareholders to choose among different value-reducing alternatives. For example, shareholders approve antitakeover charter provisions or dual-class plans because such approval is the least costly alternative presented.[2] Also, there is empirical evidence that institutional shareholders are more likely than other shareholders to vote with management in proxy contests.[3]

My research focuses on the second safeguard. It indicates that voluntary exchange does not, in fact, protect shareholders. The terms of a dual class recapitalization can be structured to compel individual outside shareholders to exchange their shares for limited voting shares even though the same outside shareholders, in the same circumstances, but acting collectively, would choose not to exchange.

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[2] For a discussion of antitakeover charter provisions see David Austen-Smith and Patricia C. O'Brien, Takeover Defenses and Shareholder Voting, Sloan School of Management Working Paper #1823-86, (November 1987). For a discussion of collective action problems in the context of dual class plans see Jeffrey N. Gordon, Ties That Bond: Dual Class Common and the Problem of Shareholder Choice, New York University School of Law, (November 1986).

[3] See John Pound, Proxy Contests and the Efficiency of Shareholder Oversight, Journal of Financial Economics, 20, (forthcoming 1988) and James Brickley, Ronald Lease, and Clifford Smith, Ownership Structure and Voting on Antitakeover Amendments, Journal of Financial Economics, 20, (forthcoming 1988).

II. Coercive Dual-Class Exchange Offers

In my research I develop a model to trace the impact of recapitalization on share prices. In the analysis, shareholders are given the opportunity to trade their shares for limited voting stock with higher dividends. This choice presents outside shareholders with a classic prisoner's dilemma.

It exploits the inability of individual shareholders to act together -- each shareholder's rational choice leads to an outcome that is worse than if all shareholders retain their original shares. This occurs because small shareholders generally ignore the impact of their exchange decision on the probability of receiving a takeover bid.

The recapitalization plans I examine entice outside shareholders with higher dividends for limited voting class shares. Examples of this type of plan include Wang Laboratories, and Hershey, among others. If all stockholders received the higher dividends, no change in value would result. The dividends would simply be financed by reducing investments that just breakeven. But the plan provides the opportunity for wealth transfers between shareholders: shareholders that get the higher dividends receive a subsidy from shareholders that retain their original shares. This provides an inducement to exchange.

The perceived costs to the individual shareholder from exchanging depend on the rules for dividing the gains from a takeover across the classes of common stock. These rules are, of course, uncertain. But an interesting result of my research is that as more of the potential takeover benefits are assigned to the limited voting class shares, the more effective is the coercion in the recapitalization plan.

For example, suppose the rule required that, in the event of a takeover, the limited voting stock would receive twice the per share takeover premium that ordinary common stock received. To a small outside stockholder, such a rule would mean that there was a double benefit to taking the limited voting shares: higher dividends and higher takeover benefits. But both of these benefits are illusions. The higher dividends come from reduced investment. And the higher takeover benefits never occur, because managers use their veto power to reject all hostile bids. This analysis implies that plans like Wang Labs which require majority approval of both classes for merger can be especially coercive.

While I focus on plans that use higher dividends to induce outside shareholders to choose limited voting class stock, there are other devices that are also coercive. For example, Dow Jones dramatically restricts the trading of its shares with superior voting rights. Shares automatically convert to limited voting stock when sold in an arms length transaction. This lack of marketability makes the Dow Jones plan at least as coercive as the dividend plans I examine.

III. An Example of a Coercive Dual-class Exchange Offer

This example focuses on a simple, all-equity firm with 1,000 shares of common stock outstanding; 200 shares owned by managers and 800 shares owned by outsiders. The annual earnings per share of the firm are $10 and the interest rate is 10%. Also, suppose there is a 10% chance of a takeover bid at $150 per share. The stock price of this firm is $105, which equals the present value of the earnings per share, $100, plus the value of the expected takeover premium, $5.

A dual-class exchange offer is announced that declares existing common stock to be class A shares with ten votes per share. Shareholders are given the opportunity to exchange their class A shares for an equal number of class B shares having one vote per share. The class B shares receive a 10% higher dividend than class A shares. In the event of a takeover, both classes would receive $150 per share.

The analysis takes the perspective of an outside stockholder who decides after all other outside stockholders have made their exchange decisions. This holder of a single share of common stock has two choices: retain the share of class A stock or exchange it for class B stock. The decision will be based on the alternative that provides the highest payoff. These payoffs depend on the decisions of other stockholders, as figure 1 demonstrates. In figure 1, P_a is the payoff from retaining the class A shares and P_b is the payoff for exchanging for a class B share.

If all other shareholders retain their class A share, then it pays to exchange for a class B share. By exchanging the shareholder gets the higher dividend and there is virtually no change in the firm's investment policy or in the chance of receiving a takeover premium. As the left-most point of figure 1 shows, the payoff to being the only class B holder is $113.99 which exceeds the class A price of $105.

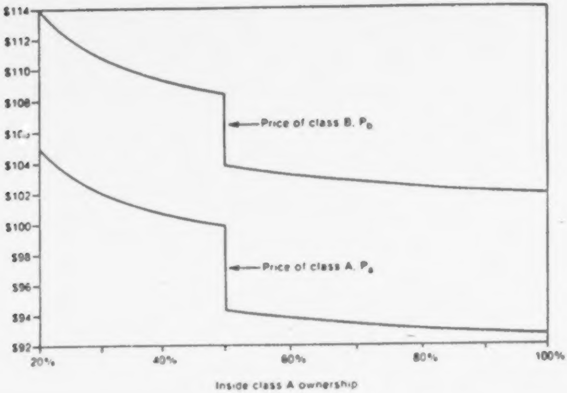
Choosing class B stock continues to be rational as more outside shareholders are assumed to exchange for class B shares, and the fraction of managerial class A ownership rises until the remaining outside shareholder is assumed to be pivotal.

Assuming that a majority of class A votes are required to obtain veto power, an outside shareholder is pivotal under the assumption that 200 outside shareholders retain class A shares and 599 exchange for class B. If the remaining outside shareholder elects to retain his class A share, managers do not obtain veto power. The pivotal shareholder's payoff to retaining class A stock is $99.91.

If the pivotal shareholder exchanges for class B, the managers obtain veto power. Even though class B shareholders

Figure 1

Payoffs for an Individual Outside Stockholder From Choosing a Share of Class A or Class B Stock.



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[1] The example assumes an all-equity firm with 1,000 shares of common stock outstanding; 200 shares owned by insiders and 800 shares owned by outsiders. Insiders always retain class A shares. The annual earnings of the firm are $10,000 and the interest rate is 10%. There is an assumed 10% chance of receiving a takeover bid at $150 per share. The class B shares receive a 10% higher dividend than class A shares.

would receive the same takeover price as class A shareholders, no such takeover will occur because managers have blocking power. Thus, the payoff from class B stock does not include expected takeover benefits. The price of class B is $103.76. The loss of the expected takeover benefits accounts for the sharp drop in the price of the class B stock depicted in figure 1.

The pivotal shareholder can either retain a class A share worth $99.91 or exchange it for a class B share worth $103.76. Note that both alternatives have lower payoffs than the initial pre-offer stock price of $105. Since a pre-offer share is no longer available, it is rational for the pivotal outside shareholder to forego the expected takeover benefits and exchange for class B. This decision results in a drop in the price of class A stock, since it no longer incorporates the expected takeover benefits.

When managers own more than 51% of the class A shares, figure 1 illustrates that the payoff from exchanging for class B stock exceeds the payoff from retaining class A stock. Class B shares receive a higher dividend and neither class gets the expected takeover benefits. Therefore, rational shareholders will elect class B shares.

In this numerical example, rational outside shareholders always exchange their class A shares for class B shares regardless of the behavioral assumptions about the actions of other shareholders. These rational choices will result in the firm's having 800 class B shares at a price of $101.85 per share and 200 class A shares at a price of $92.60. Both of these prices are lower than the stock price of $105 before the recapitalization. Both classes lose the $5 expected takeover benefit component of the initial price. The class B stock has this loss partially offset by a dividend-induced wealth transfer from class A shares.

The example shows that outside shareholders, _acting individually_, will rationally participate in an exchange offer that results in a 3% decline in the value of their shares. The plan is therefore coercive; it induces outside stockholders to accept a dual-class recapitalization that they would reject if they were able to decide collectively.

The wealth transfer from class A to class B shares results in a larger per share loss for class A shares: managers lose $12.40 per share from the exchange offer. Since the managers voluntarily initiate the exchange, they must privately value control at least $2,480, which equals the $12.40 loss times the 200 shares owned by managers. Note that managers extinguish the control premium without paying the total market value of the expected takeover benefit, which equals $5,000. Thus, managers can use the exchange offer to obtain control even when their private benefits of control are less than its market value.[4]

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[4] For an analysis of corporate voting rules when managers and potential bidders get private benefits from control see Sanford

IV. Losses from Dual-Class Exchange Offers

The losses from recapitalization evolve from eliminating the external market for corporate control. To complete a hostile takeover attempt, the bidder either has to replace the target's board of directors or has to merge with the target. Both of these avenues are foreclosed by dual-class plans.

Since the managers do not exchange their share for limited voting shares, the recapitalization results in the concentration of voting power by the managers. This concentration allows managers to effectively block all hostile takeover attempts; a hostile bidding firm that purchased all of the outside shares would not be able to gain control over the target after the recapitalization. Therefore, dual-class plans may be the most effective universal antitakeover device ever invented: they give managers that do not own a majority of the stock complete veto power over hostile bids.

The losses in this analysis come from the evaporation of the potential takeover premium when managers obtain veto power. Further losses will also result from less efficient management as managers enjoy the benefits of being insulated from the corporate control market. If the firm had sufficient inside ownership or other antitakeover provisions for the managers to block takeovers before the dual-class recapitalization, then the

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J. Grossman and Oliver D. Hart, One Share-One Vote and the Market for Corporate Control, Journal of Financial Economics, 20, (forthcoming 1988).

managerial veto power in the recapitalized firm would not change the chance of receiving a takeover bid. This may explain some of the empirical findings on firms with dual-classes of equity.

Partch (1986) examines 43 publicly traded firms that created a dual-class equity structure during the period of 1962-84.[5] She finds that this change is associated with a stock price increase of about 2%, but the significance of this result is questionable because the median effect is about 0%. Partch also reports that the average level of insider ownership is 48.6% before the recapitalization. Similarly, Gordon (1986) reports insignificant stock price changes for 19 New York Stock Exchange-listed firms that recapitalized during the period 1984-86.[6] He reports that the inside ownership of these firms was 30%. In contrast, Jarrell and Poulsen (1987) report small but significant negative returns.[7]

One explanation that is consistent with the substantial inside holdings and stock price evidence is that the managers of the firms in the samples were able to block takeovers before the recapitalization as well as after. If so, these empirical results may not be useful in forecasting the impact of a recapitalization on a typical publicly held corporation. Such typical firms have substantially less inside ownership and are subject to takeover bids. Loss of the ability to receive a takeover bid would result in a reduction in stock price.

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[5] Megan Partch, The Creation of a Class of Limited Voting Common Stock and Shareholder Wealth, Journal of Financial Economics, 18, (June 1987), 313-339.

[6] Jeffrey N. Gordon, Ties That Bond: Dual Class Common and the Problem of Shareholder Choice, New York University School of Law, (November 1986).

[7] Gregg Jarrell and Annette Poulsen, Dual-Class Recapitalizations as Antitakeover Mechanisms - the Recent Evidence, Journal of Financial Economics, 20, (forthcoming 1988).

V. Non-coercive Methods of Effecting Dual-class Equity Structures

Dual-class exchange offers can be coercive because managers set the terms and conditions for the exchange between class A and class B shares, and provide an inducement to outsiders to exchange. This presents outside shareholders with a distorted choice that can reduce the value of their claims. Nevertheless, dual-class equity may provide firms with valuable flexibility[8]. To achieve a dual-class capitalization without coercion, it may be possible to use the capital market to set the terms of the exchange.

Capital markets price securities efficiently on the basis of the cash flows that are expected to accrue to them and the riskiness of these cash flows. An initial public offering (IPO) of limited voting class shares, for example, would be priced on the basis of the security's voting rights, returns, and risk. The purchasers in an IPO have no pre-existing association with the issuing firm and therefore cannot be coerced into buying the shares. The proceeds of the offering can be used to repurchase the outsiders' common stock. The number of limited voting right shares issued, and the number of ordinary shares repurchased, determines the equity capitalization of the firm.

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[8] See Daniel R. Fischel, Organized Exchanges and The Regulation of Dual Class Common Stock, University of Chicago Law Review, 54, (Winter 1987), pp. 119-152.

Suppose the managers decide to repurchase all of the outside class A common stock at its pre-existing price through a tender offer. Using numerical values from the example, the cost of repurchasing the 800 shares owned by outsiders at the pre-existing per-share price of $105 is $84,000. This repurchase is financed by issuing 954.55 class B shares that have a 10% higher dividend than the class A shares but have no claim to takeover premiums. The price of class B shares is $88.

The repurchase and issue process increases the number of shares that have claims to the firm's dividends, and thereby dilutes the price of the managers' class A shares. The per share value of the managers' shares after the introduction of the second class of equity is $80. This is a reduction of about 24% from the initial value of $105. The loss in total equity value of $5,000 ($5 per share times 1,000 shares) is caused by the elimination of the expected takeover benefits. The non-management class A shareholders sell their shares to the firm at their fair market value. And the class B shareholders get exactly what they pay for: they pay $88 for dividends worth $88. The managers bear the entire loss of $5,000 ((105-80)*200). Therefore, under this plan managers purchase the control rights to the firm at fair market value using their own capital.

This approach is similar to the rule proposed by the Securities and Exchange Commission, 19C-4. The SEC rule would prevent firms from issuing securities or taking other actions that reduce the per share voting rights of common stockholders. The rule would allow firms to issue stock with inferior voting rights through an initial public offer. I support this proposal. It prevents managers from using their agenda setting powers to reduce the value of the outside shareholders' claims. It also preserves flexibility, allowing firms the opportunity to issue common stock with inferior voting rights.

The SEC's proposed rule is not a panacea. Managers can still use their agenda setting powers to harm outside shareholders in some limited circumstances. For example, when insiders can credibly obtain a majority of shares, outside shareholders can be exploited in a repurchase. This problem is not unique to transactions involving limited voting stock. It occurs whenever a group of shareholders can credibly obtain a majority of shares. Other examples include going private transactions, freezeout tender offers, and leveraged buyouts. It is important to extend the protection such as appraisal rights to these repurchases.

The proposed rule contrasts sharply with the recent adoption of state laws that withhold voting rights from large blockholders. These laws prevent any new shareholder with at least 20 percent ownership from voting those shares without being granted that right by the remaining non-management shareholders. At least 22 states have adopted these anti-takeover measures. Those laws disenfranchise large blockholders and insulate incumbent managers from hostile takeovers. It is therefore ironic that states are creating two voting classes of stockholders while at the same time this Committee and the SEC are considering regulations to prevent corporations from reducing the per share voting power of stockholders.

VI. Summary

Dual-class exchange offers can induce outside shareholders individually to choose limited voting shares even though they lose money from the recapitalization plan. If collective action were possible, outside shareholders would choose to defeat the exchange offer and retain a single class of equity.

The exchange offers examined coerce outside shareholders with higher dividends for class B shares. If all stockholders received these higher dividends, no change in value would occur. The dividends would simply be financed by reducing breakeven investments. But the plans provide the opportunity for transfers of wealth to shareholders who elect limited voting shares with their higher dividends from shareholders who retain higher voting shares. Outside shareholders are induced to choose limited voting B shares, therefore, to avoid the wealth loss associated with subsidizing the higher dividend payments to others and to receive a subsidy from holders of the superior voting shares. Other devices, such as trading restrictions on superior voting shares, could be used as a substitute for the dividend differential to induce outside shareholders to choose limited voting shares.

Firms can obtain the flexibility of dual-class equity structures without coercion by using the capital market to price both classes of stock separately. The limited voting shares would be issued through an initial public offering and the proceeds used to repurchase the outside stockholders' shares. This method still results in the loss of the expected takeover premium as managers obtain veto power. But unlike coercive exchange offers, this method, which is consistent with the Securities and Exchange Commission's proposed rule, forces managers to purchase the control rights to the firm at fair market value using their own money.

The CHAIRMAN. Thank you, sir.

Our final witness of this panel is Manning Warren. Mr. Warren, I understand you're a visiting professor at Emory University School of Law, Atlanta. Go right ahead, sir.

STATEMENT OF MANNING G. WARREN III, PROFESSOR OF LAW, UNIVERSITY OF ALABAMA

Mr. WARREN. Mr. Chairman, distinguished members of the committee, thank you for your invitation to testify today.

Because our time is limited, I will only emphasize several points which I've made in a written statement submitted to the committee.

The CHAIRMAN. Your statement will be printed in full in the record.

SUPPORT FOR ONE SHARE-ONE VOTE

Mr. WARREN. My position in support of a uniform voting right standard is essentially the same one Congress took when it passed the Securities and Exchange Act of 1934. It stated:

> Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Inasmuch as the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according shareholders fair suffrage.

In other words, Congress sought to link the use and benefits of our public securities markets to a duty of fair corporate suffrage for equity investors.

For the 50-year period between 1934 and 1984, this linkage held firm for a number of reasons.

First, the New York Stock Exchange, under the supervision of the Securities and Exchange Commission, maintained listing rules designed to protect this link. These rules prohibited nonvoting common stock. They also prohibited common stock in which the voting power was disproportionate to the investor's equity interest in the corporation a principle we now refer to as "one share/one vote."

Second, for over 50 years, the management of our Nation's publicly held corporations generally respected this linkage by refusing to issue nonvoting common stock or dual classes of common stock with disproportionate voting rights. Controlling stockholders were willing to give up voting power in exchange for additional equity capital. Public investors were willing to provide that equity capital in return for voting power commensurate with their investment risks.

These voting rights provided a degree of accountability to common stockholders who, unlike other suppliers of capital, had no legal or contractual priorities in their claims against corporate assets.

The disenfranchisement of public stockholders simply proved unnecessary in management's efforts to raise capital or to establish an efficient capital structure.

Third, the SEC supported this linkage pursuant to a broad grant of authority from Congress to regulate the solicitation of proxies "as necessary or appropriate in the public interest or for the protection of investors." The proxy rules were not simply to promote disclosure, but also to protect public stockholders' role in corporate governance.

Fourth, in a rare show of unanimity, both the corporate reformists and the economists generally agree that the link between trading and voting was generally beneficial to both publicly held corporations and their equity investors. The reformers' position is that the right to vote in accordance with one's equity investment guards against "financial royalism" and "power without responsibility." The economists take the position that it is "efficient" for equity investors, as residual claimants on the corporation's income and assets, to have proportionate voting power because these stockholders have appropriate incentives to promote the corporation's best interests. The economists also view the market for corporate control as a vital check on inefficient management. Accordingly, if the equity investors were deprived of voting rights, inefficient managers would become entrenched and stockholders would lose not only their collective power to remove those managers, but any control premium that might be paid for their stock.

INVESTOR CONFIDENCE

Last, and most importantly, the link between the right to a trading market and the right to vote has been supported by public investors. That link has provided a foundation for investor confidence, a perception of legitimacy.

The development of this confidence was a very slow process. It took almost 35 years for annual trading volume on the New York Stock Exchange alone to equal the volume preceding the market collapse in 1929. Recent estimates indicate that today over 47 million individual investors own equity securities directly and over 133 million investors own equity securities indirectly through pension plans, life insurance policies, and other accounts.

These public investors have relied on a congressional policy that for 50 years has linked fair corporate suffrage to the trading markets for equity securities.

This vital link between use of our securities markets and voting rights did not begin to break down until the 1980's. Its deterioration, as has been pointed out here today, resulted from an obsessive search by a number of corporate managers for the ultimate takeover defense. In my view, this search does not necessarily implicate the good faith of those corporate managers. Their concerns are understandable, given the time and money the takeover frenzy has diverted from more productive activities.

However, the vaccine these corporate insiders have developed has a broad spectrum. It not only kills off a particular takeover virus, it often kills off the public investors' potential gains from both friendly and hostile takeovers in the future, and it permanently eliminates their participation in any future corporate decisions. In other words, the cure may be much more dangerous than the disease.

The intensity of this search for the ultimate showstopper takeover defense has driven a number of corporate managers to a position in which they are willing to break the rules of the New York Stock Exchange, to delist the company's securities, and move to markets with less stringent rules in place.

The New York Stock Exchange, in order to avoid the loss of these listings and the commission income of its members, has been forced to yield. It has done so despite its leadership's continued belief in the one share/one vote standard. The New York Stock Exchange chairman has stated to Congress:

> The Exchange believes the concept of one share/one vote has been good for America, good for the Nation's capital markets, and good for investors. The ideal solution to the problems raised by the recent proliferation of tender offers would be to extend one share/one vote to all markets.

These competitive pressures have promoted, in the words of former SEC Chairman John Shad, a new race to the bottom, similar to that which occurred among State corporation codes earlier in this century.

It is not too late to stop this race. At the present time, over 97 percent of the publicly held companies traded on our largest exchanges and on the NASDAQ market have refrained from disenfranchising their public investors. However, former and present exchange officials, people who are hardly alarmists, have predicted that unless this deregulatory process is stopped soon, "the flood gates will open." And "eventually all companies will be controlled by some small inside group. Public stockholders will not have any role or significant voting rights."

If and when this happens, the linkage between our markets and fair corporate suffrage may be beyond repair. The SEC's authority to prevent this is at least questionable. In my view, Congress should act now, before the policy established a half-century ago is further undermined and before public perceptions of legitimacy are lost.

Perceptions of legitimacy are critical to the continued confidence of public investors. In recent years these investors have suffered through an array of corporate abuses that seem only to intensify with time. What are the effects of these experiences on their perceptions? What have they seen and what is the long-term impact on their confidence in our marketplace?

Public investors have observed the takeover defense tactics of corporate managers who would deplete the firm's equity to preserve control. Public investors have watched their values dissipate as corporate managers paid "greenmail" from corporate treasuries, sold the firm's most productive assets, took "golden parachute" retirement packages and otherwise scorched the very earth owned by these investors.

Stockholders were told this was all done in their best interests and the courts, for the most part, have deferred to business judgment. Public investors have witnessed an endless stream of corporate directors, investment bankers, lawyers and accountants sentenced to jail terms for insider trading and wire fraud. They have observed the successful lobbying efforts of corporate managers in Delaware and other States to repeal the duty of care owed by management to common stockholders.

Then on October 19 of last year they experienced the shock of the deepest one-day plunge in stock market history. If corporate management succeeds in eliminating stockholder suffrage, through nonvoting stock, dual class recapitalization, and other devices, it may topple the last brick that supports the system the Federal securities laws were designed to protect.

Congress does not need to pass a comprehensive Federal corporation law. Although this has been suggested since the beginning of our republic, Congress has generally followed a course of legislative restraint, supplementing State laws only where they have proven insufficient to protect national interests.

However, our nation's securities markets are beyond the reach of State law. Congress does not have to preempt State corporation law generally, just as it refused to do in passing our Federal securities laws. It should only condition the use of our securities markets upon a company's commitment to fair corporate suffrage for equity investors.

This was Congress' intent in 1934, but that policy never took the form of a specific provision in the statute. The provision should mandate one share/one vote for all publicly held common stock required to be registered under the 1934 act, and should grant the SEC authority to adopt rules consistent with the fair corporate suffrage policy. This measure will reestablish the link between power and responsibility. It will contribute to a perception of legitimacy.

[The complete prepared statement of Manning G. Warren III follows:]

STATEMENT OF MANNING G. WARREN, III*
PROFESSOR OF LAW, UNIVERSITY OF ALABAMA,
BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
UNITED STATES SENATE, MARCH 17, 1988

Mr. Chairman and distinguished Members of the Committee, I appreciate the invitation of the Committee to testify on the subject of a uniform voting rights standard for all issuers whose securities are traded in our nation's securities markets.

One Share, One Vote: A Perception of Legitimacy

Introduction

The one share, one vote rule is based on the principle of apportioning voting power commensurate with the investment risk taken by common stockholders as residual owners. These stockholders exercise their limited power only at the extremes -- to elect directors who appoint managers and to approve certain extraordinary transactions. The right to vote in accordance with one's risk provides for the ultimate accountability of incumbent managers. Without the two deterrents, risk of capital loss and fear of removal, entrenched management may exercise power without responsibility. Historically, the state was apprehensive about the corporate form because of a corporation's perpetual life and the resulting economic power it could utilize. Today, the grim prospect is that corporate managers, to assure against accountability and any loss of control, would disenfranchise the common stockholders and establish themselves as a self-perpetuating oligarchy. Although deviations from one share, one vote are permitted under modern state corporation laws, it is the model upon which those laws are based. The fair corporate suffrage ensured by the Securities and Exchange Act of 1934 (1934 Act) is premised largely on this model. The New York Stock Exchange (NYSE) firmly embraced this model over sixty years ago. Its leadership continues to emphasize that the one share, one vote listing standard is good for our investors and their public markets.

However, because some managers of listed companies fear the acquisition of voting control and their removal by third parties, they would take the votes for themselves and move their companies to a market where disproportionate voting rights are permitted. The consequent fear of losing these listings has led the NYSE to propose the elimination of the rule. The Securities and Exchange Commission (SEC) has indicated its willingness to permit access to our trading markets of common stock with disproportionate or no voting rights if existing stockholders are not disenfranchised. The states have enacted corporation codes with limited regulatory force and generally lack the authority to regulate access to public securities markets. Accordingly, the continued vitality of the one share, one vote rule is dependent upon the will of Congress.[1]

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The resolution of the issue whether to extend the one share, one vote rule across our securities markets has profound consequences for the future of corporate governance and our economic system. It is an extremely complex issue, raising hard questions as to the need for disenfranchisement techniques, the value represented by voting rights, the effects on present public policies, and, most importantly, the long-term impact on public confidence in the fairness and integrity of our securities markets.[2] After reviewing the historical background of the one share, one vote controversy, each of these questions will be addressed. The transcendent question, and the focus of any analysis dealing with the protection of investors and our securities markets, is whether the ultimate resolution of the controversy will weaken or support a perception of legitimacy.

Historical Background

The standard of one share, one vote for common stock was firmly established in this country over 100 years ago as the foundation of the corporate governance model.[3] The model, most simply stated, was that common stockholders elect directors who

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[1] Hearings have been held previously which dealt with the issue of whether a uniform one share, one vote standard should apply to all publicly-held companies. See Impact of Corporate Takeovers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 99th Cong., 1st Sess. 1110-234 (1985).

[2] See generally, Seligman, "Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy," 54 GEO. WASH. L.REV. 687 (1986); Dent, "Dual Class Capitalization: A Reply to Professor Seligman," 54 GEO. WASH. L.REV. 725 (1986); Kerbel, "An Examination of Nonvoting and Limited Voting Common Shares -- Their History, Legality and Validity, 15 SEC. REG. L.J. 37, 165 (1987); Karmel, "Qualitative Standards for 'Qualified Securities': SEC Regulation of Voting Rights," 36 CATH. U.L. REV. 809 (1987); Gilson, "Evaluating Dual Class Common Stock: The Relevance of Substitutes," 73 VA. L.REV. 807 (1987); Gordon, "Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice," 75 CALIF. L.REV. (forthcoming Jan. 1988).

[3] See 1 MORAWETZ, PRIVATE CORPORATIONS 449 (1886).

appoint officers for the management of corporate assets.[4] The one share, one vote standard was based on the principle of apportioning voting power commensurate with the investment risk taken by the common stockholders as residual owners. Common stockholders were distinguished from other suppliers of capital, from secured and general creditors to preferred shareholders, because these suppliers had contractual priorities in their claims against corporate assets. Because common stockholders only had rights in the equity, the corporate value net of these other claims, their vote was essential in exercising "control" over and, hence, securing the accountability of, the board of directors to whom they had delegated management authority. This control, to the extent utilized collectively, could be exercised primarily by removing or refusing to reelect directors. The one share, one vote standard was premised on a theory of self-interest: each shareholder, to the extent of his own capital risk, would vote for the best interest of the corporation in order to further his own self-interest.[5] The obvious corollary was that those with voting power disproportionate to their capital risk "would be tempted to use that power to further their private interest in opposition to the welfare of the corporation."[6]

The one share, one vote standard met no real challenge until the mid-1920s, a period referred to by Professor William Ripley as the years of "the vanishing stockholder."[7] The catalyst for a broad public reaction was the issue of nonvoting common stock by Dodge Brothers, Inc., a ploy that enabled the investment banking firm of Dillon, Read and Company, through its purchase of 100 percent of the voting stock for $2.25 million, to control a company in which the public had invested $130 million.[8] The so-called "stench which filled Wall Street" after this offering pushed the NYSE to adopt in 1926 a voting requirement for all common stocks listed on the exchange.[9]

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[4] See HENN & ALEXANDER, LAWS OF CORPORATIONS 490-501 (1983).

[5] See Memphis & C.R.R. v. Wood, 88 Ala. 630, 644, 7 So. 108, 113 (1889).

[6] Sneed, "The Stockholder May Vote As He Pleases: Theory and Fact," 22 U.PITT. L.REV. 23, 27 (1960).

[7] RIPLEY, MAIN STREET AND WALL STREET 84 (1927).

[8] Id. at 87.

[9] LIVINGSON, THE AMERICAN STOCKHOLDER 186 (1958); see also, Seligman, supra note 2, at 694-699.

The NYSE adopted a one share, one vote listing standard which generally prohibits the listing of nonvoting common stock, any voting common stock of an issuer which has a class of nonvoting common stock outstanding, any stock with unusual voting provisions which tend to restrict voting, and any common stocks which are part of a dual class capitalization scheme which accords voting power disproportionate to the equity interests.[10] The "dominant forces" in the origin of the listing prohibitions against nonvoting common stock and common stock with voting power disproportionate to capital risk were "public sentiment that was apprehensive of control and the notion that the common stock has the inherent right to vote."[11] The NYSE's objectives were to encourage corporate democracy, to foster responsible corporate conduct, to develop strong ties between stockholders and management, to promote corporate disclosure and to protect the investor.[12] The one share, one vote standard of the NYSE faced no serious challenge for almost sixty years.

The dilemma that recently developed is two-fold. First, the NYSE faced growing competition for listings from the National Association of Securities Dealers' (NASD) computerized trading system (NASDAQ)[13] and the American Stock Exchange (AMEX). Second, a need was perceived by corporate management for a "show-stopper" takeover defense.[14] Nothing could stop the show more effectively than successful management efforts to disenfranchise public stockholders. Once these stockholders are deprived of voting power, only management can pass control to third parties. Although AMEX refuses to list nonvoting stock,[15] neither of these competitors prohibits listing of common stock with disparate voting power. Because the NYSE no longer provided unique benefits to corporate issuers in terms of liquidity and prestige,[16] it feared an inability to attract or retain listings while demanding compliance by issuers with the most stringent standards.[17] Although this fear was precipitated by General Motors' issuance of common stock with fractional voting rights in connection with acquisitions,[18] it was magnified by subsequent issues of disparate voting stock by some twenty-five NYSE-listed companies.[19] The NYSE declared a moratorium on the application of its one share, one vote rule in 1984, and, after review by a special committee, submitted amendments abolishing the rule to the SEC for regulatory approval.[20] It is clear that the new competition carries with it the portent of "a race to the bottom" in marketplace self-regulation.[21]

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[10] NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 3, ¶ 313.00 (1983).

[11] ROBBINS, AN EVALUATION OF THE NEW YORK STOCK EXCHANGE LISTING POLICY ON VOTING 17 (NYSE Study 1978).

[12] Id. at 22.

[13] See Simon & Colby, "The National Market System for Over-the-Counter Stocks," 55 GEO. WASH. L.REV. 17 (1986).

[14] See Seligman, supra note 2, at 701; Gordon, supra note 2 at 2-6.

[15] AMERICAN STOCK EXCHANGE, COMPANY GUIDE ¶ 222 (1983).

[16] See Gordon, supra note 2 at 95.

The NYSE chairman, prior to proposing the relaxation of the NYSE's one share, one vote rule, testified that the Exchange did not want to change the rule: "Philosophically, the Exchange continues to believe in one share, one vote."[22] He stated further:

> The Exchange believes the concept of one share, one vote has been good for America, good for the nation's capital markets, and good for investors. The ideal solution to the problems raised by the recent

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[17] See SUBCOMMITTEE ON SHAREHOLDER PARTICIPATION AND QUALITATIVE LISTING STANDARDS, NEW YORK STOCK EXCHANGE, DUAL CLASS CAPITALIZATION 2-4 (1985) [hereinafter NYSE SUBCOMMITTEE REPORT].

[18] See Simonston, "GM Purchase of EDS May Spur Exchange to Alter Its Rules or Delist Auto Maker," Wall St.J., Jul. 11, 1984, at 2, col. 3. See infra, note 38.

[19] See Karmel, supra note 2, at 817. According to the Securities and Exchange Commission (SEC), more than 45 NYSE-listed companies had issued disparate voting stock or acted to limit the voting power of large shareholders during a three-year period ending in June, 1987. SEC Rel. No. 34-24623 (June 24, 1987).

[20] See SEC Rel. No. 34-24623 (June 24, 1987).

[21] See Gordon, supra note 2 at 9, 99; Coffee, "Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance," 84 COLUM. L.REV. 1145, 1257-59 (1984).

[22] Hearings Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 99th Cong., 1st Sess. 241 (1985) (testimony of John Phelan, Chairman, NYSE).

> proliferation of unnegotiated tender offers would be to extend one share, one vote to all markets."[23]

However, the force of the new competition outweighed the continued self-regulatory expression of the sixty-year-old rule.

The NYSE, on September 16, 1986, proposed the abolition of the one share, one vote rule from its listing requirements. The amended rule proposed by the NYSE would permit listed companies to issue additional classes of common stock with unequal or disparate voting rights if approved by a majority of the issuer's independent directors and a majority of its "public" stockholders, a term which excludes officers, directors and holders of ten percent or more of the voting power.[24] Listed companies which had created disparate voting rights during the NYSE moratorium without the requisite director and stockholder approval would be given two years to comply.[25] Excepted from the approval regimen were disparate classes of stock outstanding when the issuer first went public or distributed pro rata to the distributor's common stockholders in a spin-off transaction where the distributor was not the issuer.[26] The NYSE proposal was significantly less stringent than that proposed by its special committee, which had recommended a two-thirds vote for approval, a ratio of voting differential per share no more than one to ten, and no other substantial differences in rights of stockholders.[27] Comments received by the SEC on the NYSE proposal were over two to one against it.[28] Virtually all of the individual stockholders and stockholder groups, institutional investors, state securities regulators and academics strongly supported a uniform one share, one vote listing standard.[29]

The SEC, after the failure of the exchanges and the NASD to reach agreement on the terms of a uniform voting rights rule (except for a grandfather date of May 15, 1987), proposed its own rule for public comment.[30] Its proposed Rule 19c-4 would prohibit exchange or NASD listing for any common stock of a domestic issuer that after May 15, 1987, "issues any securities or takes other corporate action that has the effect of nullifying, restricting, or disparately reducing the voting rights of shareholders" holding stock registered under the 1934 Act.[31] This language, according to the SEC, is intended to prevent distributions of superior voting stock as stock dividends, recapitalizations in which stockholders are offered lower voting stock with higher dividends in return for stock with higher voting rights, or taking other action to condition voting rights on the holding period of the shares.[32] The exchanges would be given rulemaking authority to specify various types of corporate action included or excluded by the rule. The SEC proposal does not prohibit initial public offerings or subsequent offerings of stock with disparate voting rights, including the issuance of disparate voting rights stock to effect acquisitions for a bona fide business purpose.[33] If an issuer should violate the rule, none of its common stock or equity securities could be listed further.[34] The SEC has solicited and received comments on its proposed rule but has not yet taken final action.

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[23] Id.

[24] SEC Rel. No. 34-24623 (Jun. 24, 1987).

[25] Id.

[26] Id.

[27] NYSE SUBCOMMITTEE REPORT, supra note 17, at 4-5.

[28] SEC Rel. No. 34-24623 (Jun. 24, 1987).

[29] Id.

[30] Id.

These developments clearly demonstrate that the one share, one vote rule is in trouble. The NYSE proposal would eliminate it altogether. The exchanges and the NASD cannot seem to agree on a uniform voting rights standard. The SEC, in proposed rule 19c-4, would also eliminate the rule, but would impose delisting if issuers create disparate voting rights stock or take other action which would reduce voting rights of outstanding common stock. Although the SEC's proposal meritoriously offers some protection against disenfranchisement of stockholders, it does not do so as clearly or as effectively as the one share, one vote rule.

The fundamental question, of course, is whether the one share, one vote rule serves to protect our securities markets. If it does, then Congress should express that policy by statute. It should not be left to state legislatures whose regulatory schemes can be evaded by reincorporation in less reform-minded sister states. It should not be left to self-regulatory organizations which face a similar race to the bottom as a result of marketplace competition. The SEC is concerned whether it has the regulatory authority to establish corporate governance principles.[35] Its proposal extends to any corporate action that has the effect of nullifying, restricting or disparately reducing voting rights of outstanding stock. This measure takes the SEC far beyond the NYSE's one share, one vote rule, empowering it to regulate, through the threat of delisting, any corporate decision with an impact on voting rights, including poison pills, supermajority provisions, staggered boards of directors and other types of shark repellants, as well as an infinite variety of recapitalizations.[36] The one share, one vote rule, which is much less expansive, was designed to assure only fair corporate suffrage among common stockholders proportionate to investment risk. This rule, which only supplements and does not supplant the state law of corporations, is attractive because of its limited scope, its marketplace workability for the last sixty years and the contributions it makes to the interrelated values of accountability and investor confidence.

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[31] Id.

[32] Id.

[33] Id.

[34] Id.

The Basis for Disenfranchisement

For over sixty years, the largest publicly-held companies in this country with few exceptions found no peril in the NYSE's one share, one vote rule. They grew and prospered with the rule in place. It was not viewed until the recent wave of takeover activity as an unduly restrictive financial structure. Today, even in the continuing flurry of takeover activity, only approximately three percent, 200, of the 6,500 corporations whose common stocks are traded on the NYSE, AMEX, and NASDAQ securities markets, have chosen to utilize common stock with disparate voting rights.[37] Stated affirmatively, ninety-seven percent of the publicly-held corporations traded in these three secondary markets have been able to raise and utilize equity capital without disenfranchising stockholders. They have been willing to accept in exchange for that capital a commensurate loss of statistical voting control. Of the three percent who have abandoned the one-share, one vote principle, an overwhelming number has done so in the last several years to avert the loss of control that would result from the collective acquisition of a dominant voting bloc by a tender offeror. The implementation of disenfranchisement plans generally has not been to raise

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[35] SEC Rel. No. 34-24623 (Jun. 24, 1987).

[36] _See_ Coffee, _supra_ note 21 at 1147 n.3, 1257 n.338. _See generally_, Dodd, "Fair and Equitable Recapitalizations," 55 HARV. L.REV. 780 (1942).

[37] _See_ Seligman, _supra_ note 2, at 702-710.

additional capital or to facilitate acquisitions,[38] but to secure absolute, inalienable control for existing management.[39]

This is confirmed by the methods which have been used to solidify control. The following is but a sampling of the techniques:

(1) charter or bylaw provisions limiting or voiding the voting rights of stockholders who hold more than a prescribed percentage of the corporation's common stock (reducing the voting power of tender offerors);[40]

(2) charter or bylaw provisions expanding the voting rights of stockholders who hold longer than a prescribed period of time

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[38] General Motors Corp. in twice using inferior voting rights stock to facilitate acquisitions, presumably was "experimenting with a financing technique" designed in part to motivate the acquired company's managers. See Hector, "The Flap Over Super-shares," Fortune, Sept. 16, 1985, at 114, 115. The financial experiment was the linkage between dividends and the acquired company's performance; the unequal voting rights were devised to prevent H. Ross Perot from assuming a control position. See Gordon, supra note 2, at 101-102.

Although in technical violation of the NYSE's one share, one vote rule, the class of inferior voting rights common stock was issued after arms-length negotiations and both this stock and the full voting common stock of the corporation are publicly-traded. The NYSE has distinguished these transactions from most other dual class capitalization schemes, noting that others create not only unequal voting rights, but also eliminate a public market for the stock with superior voting rights. See Vise, "GM Runs Afoul of NYSE Rule," Wash. Post, Jun. 7, 1985, at B1, col. 4. However, the special common issued by General Motors has experienced difficult valuation problems because of the discretionary nature of dividend policies. See Rotbart, "GM's Class E Common Holds a Few Catches That Some Investors Might Not Understand," Wall St.J., May 13, 1985, at 47, col. 3.

[39] See Gordon, supra note 2, at 2, 11. See also, Buxbaun, "The Internal Division of Powers in Corporate Governance," 73 CALIF. L.REV. 1671, 1713-14 (1985).

[40] See, e.g., MCI Communications Corp. Proxy Statement (Jun. 5, 1981).

(disproportionately expanding the voting rights of long-term holders, including management, against tender offerors);[41]

(3) issuance of a class of common stock with superior voting rights (ten or more votes per share) to a management-controlled group or entity, frequently for consideration lower than the market price for outstanding common stock;[42]

(4) distribution of a class of unlisted common stock with contingent superior voting rights triggered by the acquisition of a prescribed percentage of the corporation's voting common stock by a group acting in consent (diluting the voting power of tender offerors);[43]

(5) distribution of a class of common stock with superior voting rights to existing common stockholders, with restrictions on transferability, including divestment of superior voting rights upon transfer (with management intending to retain its shares and ultimately secure statistical voting control);[44]

(6) Distribution of a class of common stock with superior voting rights, lower dividends and restrictions on transferability, to existing common stockholders in exchange for their voting common stock (with only management agreeing to the exchange in order to secure immediate statistical voting control);[45] and

(7) distribution of a class of common stock with inferior voting rights (one-tenth vote for share) and increased dividends to existing common stockholders in exchange for their voting

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[41] See, e.g., American Family Corp. Proxy Statement (Mar. 14, 1985). See also, Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (SDNY 1985) (stockholder approval required for time-phased or tenure voting rights).

[42] See, e.g., Alberto-Culver, Inc. Proxy Statement (Mar. 17, 1986). This method also could be utilized on a one vote per share basis to establish statistical voting control with a disproportionate equity interest. See Kerbel, supra note 2 at 42-43.

[43] See, e.g., General Cinema Corp. Proxy Statement (Nov. 14, 1984).

[44] See, e.g., Dow Jones & Co., Inc. Proxy Statement (Mar. 16, 1984); Coastal Corp. Proxy Statement (May 14, 1984).

[45] See, e.g., Kaufman and Broad, Inc. Proxy Statement (Apr. 2, 1985)

common stock (with exchange by public stockholders resulting in immediately statistical voting control for management).[46] None of these disenfranchisement techniques were designed or intended to facilitate capital formation.

The NYSE, based on its survey of listed companies, stated that corporate managers wanted the ability to thwart any takeover that is negotiated with stockholders and not with them, and that dual class recapitalizations "eventually result in the concentration of the higher voting stock in the hands of management, thereby making impossible any acquisition of the company other than in a transaction satisfactory to management."[47] This is exemplified by the proxy statements of companies proposing these measures:

> [T]he [chairman of the board after the exchange offer] would have the power to approve or disapprove proposed actions without regard to how the [other] common stockholders vote on such actions. Before the exchange offer, he held 37.3% of the voting power and other stockholders owned 62.6%; after the exchange offer, he would hold 84.2% of the voting power and the other stockholders would hold 15.6%.[48]

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> [T]he proposed amendment . . . will have significant effects on the ability of stockholders to change the board . . . or to benefit from transactions which are opposed by [corporate management; and will] render more difficult a merger proposal, a tender offer . . ., a proxy contest or the removal of incumbent directors or management.[49]

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> [T]he proposed amendment . . . [will] render more difficult . . . a proxy contest or the removal of incumbent directors or management, . . . and may

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[46] See, e.g., Charter Medical Corp. Proxy Statement (Oct. 28, 1981).

[47] See NYSE SUBCOMMITTEE REPORT, supra note 17 at 3.

[48] See Charter Medical Corp. Proxy Statement (Oct. 28, 1981).

[49] See Coastal Corp. Proxy Statement (May 14, 1984).

> deprive stockholders of an opportunity to sell their shares at a premium over prevailing market prices.[50]

Although corporate management may act in good faith to accomplish immediate goals, the long-term effects are adverse to the interests of stockholders. The primary purpose of most of these dual class recapitalizations is clearly to disenfranchise the public stockholders in varying degrees in order to provide immunization against the takeover disease. In many instances, a takeover defense may be laudable. However, the immunity obtained by disenfranchisement is broad spectrum. It not only kills off a particular takeover virus; it also kills off the stockholders' potential gains from both friendly and hostile takeovers in the future and permanently eliminates their participation in future corporate decisions. The cure may be more dangerous than the disease.

This "cure," by eliminating the "threat" of takeover, insulates corporate management from any disciplinary effects provided by the market for corporate control. Inefficient corporate managers with statistical voting control cannot be displaced -- they have eliminated the risk of loss of control to outsiders or stockholders. Regardless of whether a particular takeover is harmful or beneficial to a corporation, the market for corporate control may provide a check on the management of publicly-held corporations. For the benefit of stockholders and the economy in general, it may "discipline managers who believe they have maximized the value of the corporation's shares when, in fact, they have not."[51] The stockholder without a voice and without other meaningful disciplinary mechanisms to check corporate management[52] is deprived of both the appearance and the fact of managerial accountability. By expropriating the stockholders' voting power, corporate management has secured the collective value of the stockholders' risk capital while denying them a collective voice. Bona fide efforts to avert particular takeovers or to raise equity capital should be accomplished by alternatives with less disastrous consequences.

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[50] See Dow Jones & Co., Inc. Proxy Statement (Mar. 16, 1984).

[51] ECONOMIC REPORT OF THE PRESIDENT 189 (1985). See also, Coffee supra note 21, at 1199-1215 (the market for corporate control is a partial remedy but no substitute for other accountability mechanisms). See generally, Manne, "Mergers and the Market for Corporate Control," 73 J. POL. ECON. 110 (1965), in which the author asserts that the market for corporate control promotes a convergence of the interests of stockholders and management, contributes to corporate efficiency and discourages irresponsible and dishonest behavior. Id. at 112-113.

[52] See generally, Schwartz, "Federalism and Corporate Governance", 45 OHIO ST.L.J. 545, 553-558 (1984), in which the author addresses the insubstantial remedies afforded stockholders by state corporation laws. The effect of the internal affairs doctrine, as enunciated in Shaffer v. Heitner, 433 U.S. 186 (1977), is to permit corporations, wherever located, to select a

The Value of the Vote

The value of common stock is reflected in the sum of its several elements -- the right to dividends, if declared; the right to a pro rata portion of the firm's assets, if liquidated; and the right to vote. It has been observed frequently that common stockholders in publicly-held corporations have two ways to vote: (1) marking a proxy card or (2) placing a sell order. Presumably, the latter course, sometimes referred to as "the market rule," is retained despite disenfranchisement schemes. Those who claim stockholders are, in reality, only investors and not owners argue that this economic vote is more than sufficient to protect the interests of common stockholders.[53] Curiously, the proponents of disproportionate voting power would deny the rules of the market as they apply to corporate control but would enforce them as they apply to stockholders. Although history has shown market forces are inadequate regulatory substitutes, it is incongruous to argue that dissatisfied stockholders should be able to sell their stock in the open market, but not to a third party who seeks to purchase voting control. Nevertheless, this is the argument implicit in any scheme to disenfranchise common stockholders. By confiscating voting rights, management denies public stockholders the collective ability to sell "control" to the highest bidder. Any premium over the open market price

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jurisdiction for incorporation which provides the least stringent corporate governance standards. Id. at 551-552. If states develop regulatory schemes more protective of stockholders, corporate management can cause the corporation to flee to another jurisdiction "by the stroke of a word processor without moving a single brick or soul." Id. at 557. See also, Gordon, supra note 2, at 93. Without a uniform voting rights standard, this evasive strategy also can be accomplished by issuer migration to different marketplaces. Id. at 95.

[53] See generally, Hetherington, "Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility," 21 STAN. L.REV. 248 (1969). The author, however, admits that one purpose of both the NYSE one share, one vote rule and the 1934 Act was to restore the stockholder to power by eliminating the separation of ownership from control. Id. at 252. See also Soderquist & Vecchio, "Reconciling Shareholders' Rights and Corporate Responsibility: New Guidelines for Management," 1978 DUKE L.J. 819.

offered for that control would be payable to corporate management through negotiations in which they represent not stockholders, but themselves. Upon the announcement of a proposed disenfranchisement scheme, public stockholders may follow the market rule, leave the potential control premiums behind, and pay commissions going out and then going in to other common stocks. But the very sale creates new stockholders who face the same predicament. According to one commentator, it is "a strange polity whose members love it only because they can leave it."[54]

The latent potential for collective control is an intangible value inherent in common stock. This value is lost when voting rights are abrogated because the disenfranchised stock no longer has value in connection with the transfer or exercise of control. Most empirical studies to date suggest that reductions in stockholder voting rights negatively affect the market value of the stock with inferior voting rights.[55] However, these event studies, with their limited time horizons, do not capture the long-term negative effects. If publicly-held common stock has no latent potential for collective control, no contractually protected dividend rights, and the corporation has perpetual life, what is the value of an unliquidated residual claim on the assets? Perhaps a more significant question is how long it will take buyers in the marketplace to ask the question? Because the experiment with nonvoting stock in the 1920s was cut short by the NYSE's one share, one vote rule, no experience is available to guide us in this learning process. By abandoning the one share, one vote rule, we may get an answer we do not want to hear.

Although not legally compelled to do so, management may continue to declare dividends on the inferior voting rights stock for several reasons. First, managers holding superior voting rights stock may desire a dividend return on their own minority equity interest, and, presumably, other stockholders could not then be denied a dividend without inviting breach of loyalty litigation. However, corporate managers may find dividends an undesirable method of effecting a return on their minority interests. In a recapitalization scheme which offers stockholders non-transferable common stock with ten votes per share and a ten percent lower dividend in exchange for their voting common, it is likely that only the management group will exchange their shares. If managers hold only 9.1% of the preexisting common stock, they will hold in excess of 50.0% of the voting power following the exchange.[56] In a 100 votes per share scheme, management would need less than 1.0% of the preexisting common stock to obtain statistical voting control. The staggering cost to distribute earnings to others in order to compensate themselves may discourage the decision, especially when managers are immune from a removal vote. Managers may find other forms of self-compensation less objectionable, including salaries, bonuses, retirement benefits, investment of corporate funds in their own privately-owned projects, and even sale of control to third parties (after voting to eliminate the restrictions on transferability of their shares). Although this may unduly ascribe too much weight to the greed of corporate management, one should note that in 1983 alone total annual compensation for the twenty-five highest-paid corporate executives ranged from $2.3 million to $13.2 million.[57] Although management now needs voting control as a "shield" against takeovers, little prevents its use as a "sword."[58]

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[54] Buxbaum, supra note 39, at 1673.

[55] See Gordon, supra note 2, at 30-54 (empirical evidence suggests dual class recapitalizations decrease stockholder wealth). See also SEC OFFICE OF THE CHIEF ECONOMIST, THE EFFECTS OF DUAL-CLASS RECAPITALIZATIONS ON THE WEALTH OF SHAREHOLDERS (June 1987) (updated on July 16, 1987 to include evidence from 1986 and 1987).

Another reason management may have for continued declaration of dividends on the inferior voting rights stock is to preserve a market for additional equity offerings in the future. Management's historical dividend policy would be a critical consideration for investors in deciding whether to invest in new issues of the company's common stock. However, internally generated funds and debt securities may be sufficient to satisfy the corporation's future needs for capital. Given management's discretionary power to declare dividends, "there is nothing to stop the managers from reducing the dividends paid to zero, and allowing the stock's price to fall accordingly."[59] In this event, common stock with inferior voting rights may be appropriately described as "junk stock," "the feeblest of all securities, no more than a perpetual loan without the assurance of any return."[60] If potential buyers should conclude that common stock with inferior or no voting rights has no value except fortuitously in a liquidation, then the market for that common stock disappears.

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[56] See Gordon, supra note 2, at 56 n. 134.

[57] See Patton, "Why Corporations Overpay Their Underachieving Bosses," Wash. Post, Mar. 3, 1985, at C1, col. 3.

[58] See Buxbaum, supra note 39 at 1715.

[59] Fitzroy & Mueller, "Cooperation and Conflict in Contractual Organizations," 24 Q. REV. ECON. & BUS. 24, 39 (1984).

[60] HEARD & SHERMAN, CONFLICTS OF INTEREST IN THE PROXY VOTING SYSTEM (1987) (quoting Roland Machold, Director, New Jersey Division of Investment).

The outcome for these disenfranchised stockholders is somewhat similar to that in a leveraged buyout by management.[61] In both cases, the public stockholders are effectively divested of their voting rights and voting control of the corporation becomes privately-held. However, in the leveraged buyout, public stockholders normally are paid a premium over market price for both the voting and property rights in the common stock. In the disenfranchisement schemes which triggered the one share, one vote controversy, stockholders may have received increased dividends in exchange for their voting rights, but no compensation was paid for their retained residual claim. Because the reliability of continued dividend payments depends on the discretion of management, it is difficult to speculate on the value of the stockholders remaining property rights.

The absence of a latent potential for collective control and the lack of a legal claim to dividends backed by voting rights are both likely to reduce the value of the inferior voting rights common stock. Unfortunately for public stockholders, other declines in value may flow from their inferior voting rights. The public stockholders will be exposed to a greater risk of management inefficiency. Corporate management, with less accountability to stockholders and a nonexistent market for corporate control, will be exposed to fewer sanctions for incompetence and mismanagement. Should these inefficiencies result, the market price of common stock with inferior voting rights would be further depressed.[62]

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[61] *See generally*, Gilson, "Evaluating Dual Class Common Stock: The Relevence of Substitutes," 73 VA. L.REV. 807 (1987); *see* Gordon, *supra* note 2, at 110-111 n.224.

[62] *See* Gordon, *supra* note 2, at 105-106. Professor Gordon states that issuance of common stock with inferior voting rights harms public stockholders by imposing a "costly dilution of economic participation." *Id.* at 105. Because a residual economics claim is coupled with a limited governance role, there is increased vulnerability to opportunistic behavior by the common stockholders with superior voting rights, especially in sales of control. *Id.* at 106. To sell the inferior voting rights common stock, the firm will have to sell a larger amount at a lower price or with increased dividends to raise a given amount of capital. *Id.* Because management can divert cash flows in other ways, the additional costs of the financing falls on public stockholders. *Id.* *See also*, Buxbaum, *supra* note 39 at 1715-18.

Institutional investors have recognized the potential loss of value which results from the various disenfranchisement schemes proposed by corporate management in recent years. These investors, representing over 133 million indirect common stockholders and owning substantial blocs of publicly-held corporations, cannot easily follow the market rule. To do so could depress a given stock's price and add to market volatility. With increasing frequency, they "would rather fight than switch." They have voted consistently against disenfranchisement proposals submitted to them for approval. In one recent survey, it was found that 88% of institutional investors voted against unequal voting rights proposals.[63] However, the average level of opposition to these proposals from all stockholders was less than 15%.[64] Although due in part to large blocs held by corporate management or affiliates, it is clear that most common stockholders voted in favor of the proposals despite the potential loss of value. The answer lies not only in the coercive nature of the choices presented, but also in what has been described as collective action and strategic choice problems.[65]

The collective action problem has been described as "rational apathy."[66] In other words, public stockholders acting individually have no equality of bargaining position in negotiating rights attached to their common stock.[67] The proxy solicitation process is directed by corporate managers, is financed with corporate funds they control, and is obviously biased towards their own proposals. An organized challenge by public stockholders is enormously expensive and disproportionately beneficial. The costs required in order to collect the relevant information and then to communicate that information to, and coordinate the action of, a large percentage of public stockholders grossly exceed the benefits to a particular stockholder. No compulsory cost-sharing mechanisms are available. Public stockholders are widely-dispersed and difficult to identify and organize. Public stockholders with small stakes generally cannot afford to give the remaining stockholders a free ride.[68]

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[63] MATHIASON & ROSENBAUM, CORPORATE GOVERNANCE AND SHAREHOLDER RIGHTS: VOTING BY INSTITUTIONAL INVESTORS AND 1986 ANNUAL MEETING RESULTS 11 (1986).

[64] Id. at 24. See generally, Rosenberg, "The Revolt of the Institutional Shareholders," INST. INVESTOR, May 1987 at 131.

[65] See generally, Gordon, supra note 2 at 59-85.

[66] Id. at 60: See also, Lipton, "Corporate Governance in the Age of Finance Corporatism," 136 U.PA. L.REV. 1, 67 (1987).

[67] See Kerbel, supra note 2, at 176-177 (due to inequality of bargaining power, public stockholders do not have a free choice).

Further, dual class recapitalizations are generally proposed only when corporate management already controls a substantial bloc of the voting stock. For example, in most recent cases, 30% percent of the voting stock was already controlled by a management group.[69] Accordingly, management would need to convince less than 30% of the remaining stockholders to approve the proposal. On the other hand, an opposing stockholder must convince over 70% of the public stockholders in order to defeat the proposal. Corporate management has considered carefully these odds of success before advancing its schemes. Management of firms with high concentrations of institutional investors have demonstrated an understandable reluctance to submit disenfranchisement proposals.[70] Perhaps a lesson had been learned from the proposal of Seagram Co. to exchange ten votes per share common stock without a dividend for outstanding voting common, offering an increased dividend to those who decided not to exchange.[71] The plan was withdrawn because of opposition from institutional investors outraged at a scheme designed to double the controlling family's voting power with no additional investment.[72] Where institutional holdings are high, corporate managers have opted not to test the alleged weaknesses of corporate democracy. Apparently, when corporate managers have the blocs and no one else does, they choose to play; when others have the blocs, corporate managers stay at home. Given the high costs and the poor odds of success, the failure of a public stockholder to mount an organized campaign reflects a rational decision. As a result, individual stockholders must make decisions based on information biased toward management's position. If management also offers a reward for voting in its favor, a vote against management may result in a pecuniary loss.

Problems of strategic choice frequently arise when corporate managers offer rewards or sweeteners substantively unrelated but nevertheless tied to approval of the disenfranchisement proposal. For example, a typical proposal may offer public stockholders a choice between the status quo and a scheme which provides a second choice between accepting diluted voting rights with increased dividends or accepting superior voting rights with reduced dividends and non-transferability. Absent the immediate expectation of a control premium offer, a vote against the first choice offers no immediate improvement in position. Although the offer of a dividend sweetener is akin to being bribed with one's own money, it has a strong allure. Once the public stockholder makes the first choice in order to get a second, the trap is set.[73] The collective action problem impedes the attractiveness of the supervoting stock. Otherwise, a cohesive group of public stockholders could turn the table on corporate management and take over the company. A rational stockholder, however, does not act on this expectation. He is aware that if he chooses the stock with superior voting rights and other public stockholders do not, he will be left with non-transferable stock, ineffective voting rights and a lower dividend. Consequently, a public stockholder, without the benefit of coordination, is more likely to choose in favor of the sweetener. This choice is inherently coercive.

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[68] See Gordon, supra note 2, at 60-61.

[69] Id. at 62.

[70] Id. at 62-63.

[71] See Hector, supra note 38, 116.

[72] Id.

Actually, both choices are distorted by a lack of information. Public stockholders are asked to compare the incomparable: the value of an increased dividend without a stated duration and the value of voting rights carrying a latent potential for collective control. If they accept the dividend, given its unknown value, they suffer an unknown loss by virtue of the lost voting rights. Given the difficulty of making an informed decision, stockholders are more likely to opt for a small payment now than for an unknown amount at an unknown time. One commentator has described this scenario as a "daylight bombing raid" against stockholders and a case of using a dividend "as a bribe to get public shareholders to give up their vote."[74]

The problems of collective action and strategic choice combine to distort stockholder decisions on management proposals. Public stockholders are not provided a proxy card which permits them to vote yes for an increased dividend and no against a dilution in voting rights. Accordingly, it is specious to argue that public stockholders' approval somehow sanitizes management's proposal or that approval demonstrates no loss of value. Indeed, the better argument is that the value of the public stockholders' voting rights is demonstrated by the lengths to which management will go to take them away. As a result of these proposals, the public stockholder is not only denied value, he is also denied voice. That value and that voice will belong to a self-perpetuating oligarchy of corporate princes.

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[73] The NYSE's proposed "public" stockholder approval requirement exacerbates the problem if management threatens to recapitalize based on the simple majority vote of all stockholders required under state law. The public stockholder who values voting rights more highly than the increase in dividends may vote for management's proposal solely to avoid delisting of the stock. *See* Gordon, *supra* note 2 at 77-79.

[74] *See* Hector, *supra* note 38, at 117.

The Contravention of Public Policy

Recent efforts by the management of publicly-held corporations to disenfranchise their public stockholders directly contravene a fundamental policy of the 1934 Act -- that of assuring fair corporate suffrage. The 1934 Act was passed during a period when one share, one vote was the norm in corporate governance. For Congress, it was a guiding principle in drafting comprehensive legislation to protect investors and their marketplace, a marketplace which now, as then, is "as sensitive as a hair trigger."[75] Congress determined, after extensive hearings, that an issuer's use of public markets for its equity securities should be conditioned on a grant of fair corporate suffrage to stockholders. Congress, in the House Report on the 1934 Act, expressed its intent that a link be established between the right to trade and the right to vote:

> Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange.[76]
>
> Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according shareholders fair suffrage.[77]

This linkage was intended to prevent the self-perpetuation of individuals managing publicly-held companies.[78] To effect this policy, Congress delegated to the SEC the power to regulate the solicitation of proxies "as necessary or appropriate in the public interest or for the protection of investors."[79] This

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[75] H.R. REP. NO. 1383, 73d Cong., 2d Sess. 4(1934).

[76] Id. at 13.

[77] Id. at 14.

[78] See Karmel, supra note 2, at 824.

[79] 15 U.S.C. § 78n(a) (1982). Id.

policy was not simply to promote disclosure, but also to protect the public stockholders' role in corporate governance.[80]

The disclosure policy embraced by Congress and enforced by the SEC assumed that common stockholders had voting rights and that these rights could be exercised more meaningfully with full disclosure by corporate management. The proxy disclosure rules promulgated by the SEC[81] operate as "a governor on the conduct of management."[82] According to a former SEC Commissioner, mandatory disclosure provided two sanctions management would prefer to avoid:

> Management may not fear rebellion by shareholders, but they do fear the pen of Forbes, The Wall Street Journal, Barron's and other commentators on the corporate scene if they expose to public view the manner in which they have utilized their positions for private gain. Not only may they suffer the opprobrium that follows from disclosure, they may also become the targets of suits spawned by the disclosure.[83]

The sanctions of opprobrium and stockholder litigation provide important disciplinary mechanisms which promote managerial accountability. However, the discipline provided by disclosure is insufficient to satisfy Congress' primary goal of ensuring fair corporate suffrage. If the vote is separated from common stock, by outright severance or disproportionate reduction, possibilities for effective public investor participation are precluded.

The notion of fair corporate suffrage was not simply a political platitude. Congress was concerned about Professor Berle's warning that "power without responsibility is philosophically a perilous matter."[84] The legislative history of the 1934 Act indicates repeatedly that the danger to be addressed was the lack of accountability which results from the separation of ownership from control. Congress was afraid of managers for whom the use of others' savings was "an impersonal thing."[85] Reciting the words of President Wilson, the House Report expressed Congressional antipathy to "economic undertakings upon the monarchial or aristocratic principle," stating that "society cannot afford to have individuals wield the power of thousands without personal responsibility."[86]

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[80] Professor Loss has noted that § 14(a) of the 1934 Act is "considerably more general" in scope than the specific disclosure provisions in the statute. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 512 (1983).

[81] 17 CFR § 240.14a-1, et seq.

[82] Sommer, "A Keynote Address of Sorts," 31 BUS. LAW. 870, 875 (1976).

[83] Id.

[84] Berle, "Non-voting Stock and Bankers' Control," 6 HARV. L. REV. 673, 674 (1926).

Regardless of motivation, when corporate managers promote devices which cut away voting rights from publicly-held common stock, they not only frustrate "fair corporate suffrage," they eliminate it. These schemes signal a return to the "financial royalism" Congress sought to proscribe.[87] In a recent exhaustive treatment of the one share, one vote debate, Professor Jeffrey Gordon of New York University School of Law concluded:

> The formal unbundling of corporate governance from residual economic participation may create the fact or appearance of a self-perpetuating managerial elite wielding unaccountable authority over tremendous economic resources.
>
> [T]he notion that high corporate office is earned and retained on the sufferance of marketplace scrutiny is a comforting one. We need no corporate princes here.[88]

The one share, one vote principle works to prevent an escape from scrutiny, to prevent the self-perpetuation of corporate princes who rule over firms with perpetual life, enriched with the equity capital of public investors without a voice. It promotes a perception of legitimacy.

Perceptions of legitimacy are critical to the continued confidence of public investors. In recent years these investors have suffered through an array of corporate abuses that seem only to intensify with time. What are the effects of these experiences on their perceptions? What have they seen and what is the long-term impact on their confidence in our marketplace? Public investors have observed the takeover defense tactics of corporate managers who would deplete the firms' equity to preserve control. Public investors have watched their values dissipate as corporate managers paid "greenmail" from corporate treasuries, sold the firms' most productive assets, taken "golden parachute" retirement packages and otherwise scorched the very earth owned by these investors.[89] Stockholders were told this was all done in their best interests and the courts for the most part have deferred to managerial judgment.[90] Public investors have witnessed an endless stream of corporate directors, investment bankers, lawyers and accountants sentenced to jail terms for insider trading and wire fraud.[91] They have observed the successful lobbying efforts of corporate managers in Delaware and other states to repeal the duty of care owed by management to common stockholders.[92] Then, on October 19, 1987, they experienced the shock of the deepest one day plunge in stock market history. If corporate management succeeds in eliminating stockholder suffrage, through nonvoting stock, dual class recapitalizations and other devices, it may topple the last brick that supports the system the federal securities laws were designed to protect.

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[85] H. R. REP. NO. 1383, 73d Cong., 2d Sess. 5 (1934).

[86] Id.

[87] DEBEDTS, THE NEW DEAL'S SEC: THE FORMATIVE YEARS 201 (1984).

[88] Gordon, supra note 2, at 112-113.

These perceptions of legitimacy are endangered not only by the fact of disenfranchisement, but also by the potential economic results. Insulated from public stockholders and the market for corporate control and operating under state corporation codes with limited regulatory force, corporate management may become complacent, slothful and risk averse. The breaking down of disciplinary mechanisms portends inefficiencies that could seriously undermine the nation's economy. The disenfranchisement of public stockholders amounts to a serious tampering with the free enterprise system.[93]

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[89] See generally, Easterbrook & Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer," 94 HARV. L. REV. 1161 (1981) (defense tactics allow managers to entrench themselves and avoid accountability to stockholders).

[90] See generally, Note, "The Misapplication of the Business Judgment Rule in Contests for Corporate Control," 76 NW. U. L. REV. 980 (1982).

[91] See Warren, "Who's Suing Who? A Commentary on Investment Bankers and the Misappropriation Theory," 46 MD. L. REV. 1222, notes 1-12 and accompanying text (1987).

[92] See DEL. GEN. CORP. LAW § 102(b)(7). This provision, subject to certain exceptions, permits corporations to "relieve directors ... from personal liability ... for any breach of the duty of care which involves gross negligence in the performance of such duty." Mobil Corporation Proxy Statement 17 (March 16, 1987).

In adopting the 1934 Act, Congress clearly sought to link the use of our public securities markets to the duty of fair corporate suffrage. To implement this policy, Congress granted broad authority to the SEC to protect investors and the public interest. In reliance on the qualitative listing standards of self-regulatory organizations under its supervision,[94] the SEC, until recently, has focused on the disclosure, rather than the fair corporate suffrage, aspects of the policy. The linkage afforded by listing standards has been weakened and potentially destroyed by intermarket competition. The SEC has belatedly recognized that disenfranchisement techniques now employed by corporate management "could render substantially ineffective the proxy protections" embodied in the 1934 Act.[95] However, the self-regulatory organizations cannot reach agreement among themselves or with the SEC. The NYSE would abandon one share, one vote, with the concurrence of the SEC so long as voting rights of outstanding stock are not compromised. Despite the clamor, the steady deterioration of public investors' voting rights continues. Congress should reaffirm its policy before the link is beyond repair.

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[93] Vise, "John Whitehead on Securities Industry Issues," Wash. Post, Feb. 10, 1985, at G2, col. 5. *See also*, Buxbaum, *supra* note 39, at 1677 ("the perceptible erosion of shareholder participation in corporate governance has profound consequences for the effective functioning of corporations and for their socially perceived benefits").

[94] Section 19(c) of the 1934 Act grants the SEC authority to "abrogate, add to and delete from the rules of a self-regulatory organization as [it] deems necessary or appropriate ... to conform [the] rules to requirements of [the 1934 Act] ... or otherwise in furtherance of [the Act's] purposes." 15 U.S.C. § 78s(c) (1982). Further, section 11A(a) of the 1934 Act directs the SEC, in developing a national market system, to adopt rules to assure "fair competition among exchange markets," a standard which directs that substantive regulations should not be unequal or have disparate impact on the ability of a market to attract issuers or investors. 15 U.S.C. § 78k-1(a) (1982). Similarly, section 11A(c)(4) directs the SEC "to amend any rule imposing a burden on competition" which is not in furtherance of the purposes of the 1934 Act. 15 U.S.C. § 78k-1(c)(4) (1982).

[95] SEC Rel. No. 34-24623 (Jun. 24, 1987).

The **Chairman**. Thank you very much, Mr. Warren.

Gentlemen, we have another panel that's going to appear right after you that takes the other viewpoint, so I hope we can confine our questioning to 5 minutes each. We will start with Mr. Grasso.

Mr. Grasso, later this morning we will hear a number of reasons why legislation should not require corporate issuers uniformly to allocate one vote per share for common stock.

It's argued, among other things, that such a requirement, No. 1, would unnecessarily prohibit legitimate and useful corporate structures such as General Motors, Hershey Foods, Dow Jones, Times Mirror and others now have. No. 2, it would prevent boards of directors from taking those actions which their fiduciary obligations under State law may counsel them to take in order to protect stockholders. No. 3, it would eliminate the investment alternative represented by varied capital structures; and No. 4, it is not predicated upon an identified need.

Mr. Grasso, what do you think about such arguments?

Mr. **Grasso**. Mr. Chairman, the basis of the stock exchange's position supportive of the SEC's proposed rule which would address the issue of diminution of existing or the possibility of the issuance of stock with diminished voting rights was a philosophical balancing of the historical one share/one vote philosophy that has served our markets very well, coupled with a recognition of the changing environment in which we live—changing environment in the sense of the need to maintain flexibility in terms of raising new capital both for existing companies in the public marketplace and for companies entering the public marketplace for the first time.

I think the recital is a comprehensive one in the sense that it points to the construction that may apply if indeed a uniform one share/one vote requirement were mandated.

Our belief and our support of a change is predicated upon two things—flexibility and leaving with the stockholders the right to determine their fate and to affect capital policy of the issuing companies in which they invest.

The **Chairman**. Mr. Monks, you will be followed by Mr. Sommer, a highly respected former SEC commissioner who I'm sure you know. He will appear on the second panel. He says on page 4 of his prepared testimony:

> The only rule today that mandates that corporations not depart from a one share/one vote standard is not an act of Congress, it is not an enactment of any State, it is not a rule of any Federal or State agency. The only mandate is in the rules of the New York Stock Exchange and that applies to only about 1,700 of the more than 10,000 corporations that may be said to be publicly held.

Now in contrast, you say on page 1 of your testimony,

> Federal law for the past 60 years has provided one share/one vote is a requirement for corporations listed on the New York Stock Exchange.

Who is right on what is the state of the current Federal law on the one share/one vote standard?

Mr. **Monks**. Mr. Chairman, Mr. Sommer is a very great scholar and in the occasion that I were to disagree with him, I would probably think he was right. Fortunately in this case, our viewpoints are compatible and I will try to explain.

As I mentioned in my oral testimony, the previous time in this country's economic history when we had to pay the price for separating ownership and control, which was in the 1920's, the Congress dealt with the entire panoply of business organizations and they decided pointblank—public utilities, one share/one vote; investment companies, one share/one vote. They then, in a measure of restraint, Mr. Chairman, which in the 1930's makes one think that our ancestors possibly were wiser than we, the Congress did not directly legislate for industrial companies, but they improved on two phenomenon, Mr. Chairman. One, that at that time the New York Stock Exchange had a virtual monopoly on capital-raising capability for industrial companies and, two, that largely as a result of a rather famous article by a Harvard professor named William Ripley called "One Share/One Vote," public attention had caused the exchange in the late 1920's to adopt a one share/one vote rule.

So the Congress did not tamper with the mechanism that worked for industrial companies. Thus, there was Federal law in the area of investment companies and public utilities and the Federal Government in passing the 1934 act and establishing the self-regulatory organizations permitted to continue the New York Stock Exchange virtual monopoly regulation of American industry.

The **Chairman**. Well, as you know, I think very highly of Harvard. Both you and I went there. They do a lot of good things there but I don't think they can enact Federal law. My time is up.

Senator Armstrong.

Senator **Armstrong**. Mr. Chairman, I congratulate the panelists for some very interesting and instructive testimony.

CORPORATE GOVERNANCE

Mr. Grasso, you mentioned in your prepared statement that attitudes in this country have changed toward the issue of corporate governance.

I wonder if you would elaborate on that. In the course of this change of attitudes, have you observed a large number of small shareholders who have come to you clamoring for a change in corporate governance? Have you observed a lot of pension funds coming to you and saying it's time that we give up our voting rights and so on?

Or, in fact, is this change you described exclusively, or almost exclusively, the change that has arisen from the urgings of the officers and directors of large corporations?

Mr. **Grasso**. Senator, in my remarks, I referred to the fact that we had, through a special committee of our board, probed over 3,000 constituents on the subject of one share/one vote and I further highlighted the fact that the response rate, which was slightly over 400, was heavily weighted from the corporate community.

I think it is fair to say——

Senator **Armstrong**. When you say the corporate community, you mean people who are either officers, directors or employees of the corporations that are listed on the exchange?

Mr. **Grasso**. Corporations primarily responding as corporate entities to that probe.

I think the reflection of attitude has been well stated at this panel. Jay Goldin's Council of Institutional Investors has a very clear and firm position that there should be no move away from the one share/one vote standard. On the other hand, the corporate attitude of the listed companies that responded to that probe clearly reflected a need to move into a flexible rather than a rigid or a standard one share/one vote.

Senator ARMSTRONG. Mr. Grasso, would I be correct in saying or would it be fair for me to say that there is no observable sentiment or practically none among individual shareholders or among people like Mr. Goldin, who manage pension funds, in this direction; that the notion that somehow we ought to change the one share/one vote idea arises exclusively or almost exclusively from managements that are either threatened or think they might be?

Mr. GRASSO. Well, I would have to say that the reflection of attitude from the corporate community, listed companies again, is overwhelmingly in support of a modification, whereas the attitude of the institutional investor community for the most part would oppose any modification. I don't think there is any——

Senator ARMSTRONG. But by a slight margin? In other words, would the institutional investors be 60-40 against it or 70-30? Might they be as much as 93 percent?

Mr. GRASSO. I would have to say it was close to the 90 percent level in opposition.

Senator ARMSTRONG. Mr. Chairman, let me just note in passing that the New York Society of Security Analysts reported that 93 percent of respondents in their survey said that each share of common stock should have one vote on all shareholder voting matters.

Mr. Grasso and I are on the same side of this issue and I'm not trying to be confrontational, but I do want to draw this out.

Isn't it a fact, Mr. Grasso, that the reason that the New York Stock Exchange is considering changes in its longstanding policy is simply that because other exchanges do not adhere to one share/one vote there is a fear or concern or danger or risk that some companies which you like to have listed on the New York Stock Exchange, which in fact are important to the economic well-being of the Exchange, might get off the New York Stock Exchange and go over to American or NASDAQ unless there's a universal rule, which doesn't exist at the present time?

Mr. GRASSO. I believe that our chairman's response in terms of our historical support for a uniform one share/one vote requirement and clearly the modification that we have advanced recognizes the fact that there is not a uniform standard across all other markets and that markets have indeed become competitive from a regulatory point of view rather than from a market competition point of view.

Senator ARMSTRONG. Shopping around for whatever is the most favorable?

Mr. GRASSO. Exactly.

Senator ARMSTRONG. Thank you, Mr. Grasso.

Professor Warren, I listened with great interest and admiration to your statement. You have a way with words and, of course, I agree with what you had to say.

Mr. WARREN. Thank you, Senator.

Senator ARMSTRONG. I was particularly interested, however, in the notion which you expressed that this is not something that ought to be left to the Securities and Exchange Commission, that the practical reality—if I understood what you were saying—was that Congress ought to do it and even if the SEC did it it wasn't the right answer. Is that your view?

Mr. WARREN. Well, I think it's questionable as to whether the SEC has the authority to act. I've taken a position in a comment letter filed with the Securities and Exchange Commission that they do have the authority, but I understand there's a substantial amount of opinion to the contrary. The American Bar Association, for instance, filed its comments challenging the SEC's authority under section 19(c) of the 1934 act, under section 14, and under the Williams Act amendments to the 1934 act. So there's a legitimate question as to whether the SEC does in fact have that authority.

I also think that the breadth of the rule they've proposed, proposed rule 19c-4, could do a lot more than Congress has authorized the SEC to do under the 1934 act.

Senator ARMSTRONG. Mr. Chairman, on the floor Senators have the right of unlimited debate, but I guess we only have 5 minutes here, so I'll abide by that sensible rule.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Grasso, assuming that Congress decides to impose a uniform one share/one vote requirement across all markets, would you favor any exception? If you do, which ones would you favor?

Mr. GRASSO. Well, Senator, we would clearly have to deal with those companies that are currently in the public arena with——

Senator SHELBY. Grandfather them in?

Mr. GRASSO. Exactly. And that would be my primary concern.

Senator SHELBY. If the SEC proposes the one share/one vote rule and you're talking about the grandfather exemption—in other words, I would assume from your statement then that you wouldn't be for a requirement for the companies to recapitalize back to one share/one vote—the ones that are already out there?

Mr. GRASSO. I think it would be very difficult to force a recapitalization once a company is in the public arena with multiple classes of stock.

Senator SHELBY. Mr. Monks, were you suggesting that this committee should endorse legislation prohibiting dual classes of stock to as great an extent as is legally possible? In other words, I think what you called coercive recapitalization? Would you like to expand on that?

Mr. MONKS. Senator, my personal opinion is the former, and my recommendation is the latter.

COERCIVE RECAPITALIZATION

What I was recommending to the committee is what Mr. Ruback, I think particularly lucidly referred to as coercive recapitalization should be made illegal in my view.

As Senator Armstrong said in his prepared remarks at the beginning of the hearing, if you have initial public offering stock and if people are on notice that what they're getting is without vote, then you have a set of circumstances in which nobody is being misled.

In my own view, having been in the fiduciary business, having been the ERISA Commissioner, and now a trustee of the Federal Employee Retirement System, I can tell you, fiduciaries, who are 50 percent of the market, that might be criticized for buying nonvoting stock. But as a matter of law, I see nothing objectionable to there being a legal capacity to offer it.

So my comments, Senator, were focused on what Mr. Ruback calls coercive recapitalization.

Senator SHELBY. Mr. Chairman, I do want to correct the record a little bit on Mr. Warren. Although he is a visiting professor at Emory University, he's from my home town of Tuscaloosa, AL and a professor at the University of Alabama Law School and we're glad to have him here.

I'd like to ask him this question and elaborate on what Senator Armstrong mentioned earlier.

Do you believe now that the Securities and Exchange Commission has the authority under the law to impose a uniform voting rights listing standard?

Mr. WARREN. I think it does, Senator Shelby. I think that the SEC does have the authority to develop uniform listing standards for self-regulatory organizations.

Senator SHELBY. If Congress were to adopt the one share/one vote rule, do you believe that would be interfering with a corporation's ability to raise capital in the markets?

Mr. WARREN. No, Senator, I do not. The listed companies on the New York Stock Exchange for 50 years had no problems with the exchange's one share/one vote rule. If management or control groups don't want to give up statistical voting control, they can sell less than a majority of their common stock or they can sell securities like bonds and preferred stock which give investors the protection of a legal or contractual priority on income and assets. They shouldn't be able to take the savings of an equity investor and give him in exchange an unliquidated residual claim without any enforceable right to a return on his investment.

Senator SHELBY. Mr. Ruback, how does a dual-class recapitalization structure harm nonmanagement shareholders? Would you explain?

Mr. RUBACK. Well, it harms them when the exchange offer is structured so that shareholders are induced to exchange even when it's against their best interests.

As an example, suppose you go to a restaurant and discover that your favorite item has been taken off the menu. You're now faced with a number of choices but none of them are what you wanted. You have to pick one, even though you may have been better off before you entered the restaurant. That's what I mean by agenda setting powers.

Senator SHELBY. Do you believe overall that it's in the interest of corporate America and the shareholders that own corporate America that we have a uniform one share/one vote rule?

Mr. RUBACK. No. I think it is critical that we control very carefully the exchange process, but that we also allow nonuniform voting right securities such as common stock without voting rights issued through an initial public offering.

Senator SHELBY. My time has expired.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

I want to commend all of the members of this panel who helped me considerably in thinking through some of the questions I indicated were on my mind.

I gather from the comments that we may have two different criticisms. One is a criticism of a deviation from the one share/one vote principle per se; and second is a criticism of the means by which a deviation from one share/one vote might be achieved.

As I write down the members of the panel, I would put Mr. Goldin and Mr. Warren in the first category, and Mr. Grasso, Mr. Monks and Mr. Ruback in the second category.

Would you agree with my placement of you in terms of where your criticism lies?

[No response.]

EFFECTS ON COMPANIES THAT DEVIATE FROM ONE SHARE/ONE VOTE

Senator GRAHAM. By silence, if that's agreement with my placement, then let me ask, for those who are in category one—that is opposed per se to the deviation from one share/one vote, which I guess leaves us with Mr. Warren—what has the marketplace said about these deviations? That is, are companies which deviate from one share/one vote being punished in the marketplace in the sense that investors aware of the deviation, everything else being the same, will reduce the market value of the stocks which deviate from one share/one vote?

Mr. WARREN. Senator, in response to your question, I perhaps shouldn't have been so silent. I am not opposed to more than one vote per share. There can be 100 votes per share if those votes represent a proportion of equity investment in a particular corporation.

So there's no magic in one share/one vote. The one share/one vote only indicates a one-to-one ratio between voting rights and investment.

Senator GRAHAM. That was the way I was defining one share/one vote was equality between—the political and economic interests would be proportionate.

Mr. WARREN. With respect to punishment for those who have utilized it, that's a more difficult question. It's difficult because since the New York Stock Exchange put its standard in place in the 1920's we haven't had a great deal of experience with disproportionate voting classes.

It was the only exchange that adopted the one share/one vote rule and yet we're still in a situation today where 97 percent of the companies listed on New York, AMEX, and NASDAQ do not have dual-class voting rights. So there's not a lot of experience to guide us.

In my written statement, I point out that if you have a company—Adolph Coors has been mentioned—with a class of voting stock held by a control group and nonvoting stock held by public shareholders, then as long as the management—that founding family—stays in place, they may continue to provide an earnings stream to that particular class of nonvoting stock. And if they do, that stock may have a market. In other words, people will continue to buy and sell that stock. But it has to be remembered that because it is not preferred stock, there is no legally enforceable right on the part of those stockholders to assure a continuation of dividends. So if dividends should cease, the investor at that point is in a position where he can't remove management and change the dividend policies, he can't force a liquidation to take his residual interest out of the corporation, and he may not even be able to sell the stock once the public perceives the dividend stream has stopped.

Senator GRAHAM. Mr. Chairman, if one of the persons who's currently testifying is not going to make this analysis available, I would suggest that this committee before we take final action might want to pursue that empirical question of whether the marketplace is taking less than proportionate political and economic interest into account and, if so, is that a satisfactory way for society to let the issue be resolved; and, if not, what is the basis of governmental intrusion into the marketplace?

The CHAIRMAN. Mr. Ruback would like to comment.

Mr. RUBACK. Yes, sir. There have been a number of empirical studies that have very carefully examined the stock price consequences of the firms that went from single equity capitalization to dual-class equity capitalization.

The CHAIRMAN. We can also ask the second panel that question.

Mr. RUBACK. And it's summarized in my written report. You find very little stock price response, but that's largely because these companies tended to be 50 percent inside-owned before the recapitalization. So it's not clear there's a change in control.

Senator GRAHAM. The first phrase of your response, did you say there had been some studies?

Mr. RUBACK. Yes, there have been four studies that are quite good.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman.

I'm pleased we're having this interesting discussion of one share/one vote and I want to spend a little time this morning reviewing a bit of the history on this and the deliberations we've had so far.

PROBLEMS WITH ONE SHARE/ONE VOTE

In summary, after all of the deliberations of the last years, I have come to the conclusion that one share/one vote is one of those ideas that sounds good if you say it fast enough, but when you get in underneath it there are just a lot of problems and I'll cite some of those.

A couple or 3 years ago, we had a very extensive endeavor with the American Stock Exchange, the New York Stock Exchange and NASDAQ attempting to sort through whether or not we could come to agreement and ultimately that all fell apart. And it fell apart, as I remember it, for a couple of fundamental reasons.

One, it was felt by a number of the smaller and newer companies that this would disadvantage them and they resisted very sharply. Second, it was felt that we should not try to do this by law, by fiat, from the Congress, that it was enormously complicated and difficult and it should and could be left to the SEC.

Second, as Senator Graham touched upon, there was a set of real difficulties saying why should we in the Congress get into making this kind of a rule. Why should we not leave that up to companies to structure themselves? They have different ways of doing it and why shouldn't a company with different kinds of demands be able to structure itself in the way that it wanted to? As long as there was disclosure of what the company was doing and the shareholder was not disadvantaged. After all, one of the important things is to assure that there are shareholder disclosures.

Finally, that broad array of companies was very impressive to me and remains so, running all the way from Turner to TCI to ATC which are in my back yard a lot of communications areas that I dealt with. Others are General Motors, Wang, The Washington Post, and Texas Air—all of whom have differential processes of governing themselves, which seems to me tells us something.

Finally, I'm struck with kind of the grandfather argument that gets made. We'll let companies that are family owned or whatever be grandfathered in, but after that we're not going to allow them to move ahead. It doesn't seem to me that's fair for the new family owned company that comes into being and says it wants to maintain its family ownership and then to raise capital. It would be disadvantaged if we were to pass a one share/one vote rule with a grandfather in it. It doesn't seem to me that that's quite fair.

So I think that the arguments are pretty strong against it, though again it's an interest idea going to kind of our sense of fairness and democracy.

The one area, Mr. Chairman, which I wanted to ask you all about, is how one responds to the argument that unequal voting rights protects incumbent management to the detriment of the shareholders?

It seems to me that's the vexing one that we end up with and I've never been able to really get a handle on—at least from my own perspective, get a handle on that one. Maybe you all can help me in casting a little light on that. From my perspective, that's the last remaining gap in what I think should be opposition to an idea that, as I say, sounds good if you say it fast enough. That's the one final problem that I have.

Mr. RUBACK. Well, if I can respond, if you imagine the way corporate control changes occur and especially hostile ones where management opposes the change, the bidding firm has to somehow circumvent management, usually through a tender offer, by buying stock in the marketplace. Sometimes a hostile takeover occurs through a proxy fight by encouraging others to vote a different slate of board of directors.

If the management controls the voting rights, then both those processes cease to work.

Senator WIRTH. I understand that.

Mr. RUBACK. So you do get entrenchment.

Senator WIRTH. It seems to me that that's the only argument that I can see for one share/one vote, isn't it? If you don't want to have management entrench itself in an unfair fashion, you go to one share/one vote.

Mr. RUBACK. Or initial public offerings of nonvoting stock. It's not so critical that management gets those control rights. It is critical that managers use their own money to purchase their control rights.

Senator WIRTH. Let's assume that we grandfather it in such a way that you can't do that in the future. That's one of the arguments that's made. So what you have to do is look at existing companies and management entrenching themselves, and that's the remaining argument. That's the only argument that I can see that may have some validity. How do you explode that argument? Or maybe none of you are wanting to do that.

Mr. MONKS. Do you view that argument as being the same one as being leery of the perpetuation of the concentration of power in hands that elect themselves?

Senator WIRTH. That's the same argument. I understand that. What's the argument against that? How do you defend the practices of management putting power into the hands of a few—say you buy the share of stock and then the company changes its rules and the shareholder goes in under one set of circumstances and ends up finding himself in another set of circumstances.

Mr. MONKS. My only answer to that, Senator, would be out of the Federalist Paper No. 51, and on the first three words, which are "If men were angels."

Senator WIRTH. If what?

Mr. MONKS. "If men were angels," then there would be an answer to your question, but men aren't angels.

The CHAIRMAN. Senator Wirth, you might consider the next panel which is the panel that is on the other side of this issue.

Senator WIRTH. I thought these guys, though, having thought about both sides and are good lawyers here, we might get an answer.

The CHAIRMAN. Well, there's no question that these gentlemen are on the side of one share/one vote, I think all the way, and the next panel is on your side.

Are you all through?

Senator WIRTH. Yes.

The CHAIRMAN. Thank you, gentlemen. You've been an excellent panel and I think you've given us real enlightenment. We appreciate your testimony.

Our final panel, a very distinguished panel, consists of Jeff Coors, who is the president of the Adolph Coors Co. in Colorado; John Hechinger, chairman of the board of the Hechinger Co. in Landover, MD; A.A. Sommer, who is a partner in Morgan, Lewis, & Bockius, a former SEC Commissioner; and Richard Troy, chairman of the Securities Law Committee of the American Society of Corporate Secretaries.

Mr. Coors, I understand you, unfortunately, have to leave early, but we're delighted to have you here for as long as you can be. Go right ahead.

STATEMENT OF JEFFREY H. COORS, PRESIDENT, ADOLPH COORS CO.

Mr. Coors. Thank you very much, Mr. Chairman and Senators, for the opportunity to address you today.

I represent one of those companies that have a dual class of stock. We have had a dual class of stock even before we entered the public market. So it is the position of Adolph Coors Co. that legislation restricting the trading of multiple classes of stock with disparate voting rights is inappropriate.

MULTIPLE CLASSES OF STOCK

I'd like to review some of the benefits I see in multiple classes of stock and use Adolph Coors Co. as a case in point. I would like to review the penalty our shareholders would have by the restrictions being considered and I'd like to recommend appropriate action to deal with the disenfranchisement issues that have been raised today.

The availability of automated quotation systems like the NASDAQ NMS system have allowed our company to grow and to prosper as a family managed company with an active and liquid marketplace for our shareholders.

Our company was founded in 1873 by my great-grandfather, Adolph Coors. It was his desire that the family continue after him as a family managed business. So he set up a structure in which the voting control was vested in those family members active in the management of the business, but he wanted to provide an equity basis for the other family members—he had six children—so for the other family members not active in the business, he provided an equity basis of equal amount.

The voting control has passed into a trust established by my grandfather, Adolph Coors, Jr. The conditions of that trust are that the trustees be active in the management of the business and those trustees vote the entire A class stock voting interest in our company. The equity, of course, the class B shares, have passed to other family members.

We were able to remain as a private company for 102 years, but in the early 1970's we were faced with severe estate tax problems at the passing of the second generation of the family and we had a decision to make, whether to go into the public market and allow the trading of the shares for those estates to be settled or to borrow literally hundreds of millions of dollars which were required to settle those estates.

Our decision was to go public, to allow the public in through a secondary offering. The initial offering was 12 percent of our class B shares. No proceeds of that offering went to the company, only to the shareholders and the shareholders' estates. It was not used as a defensive tactic, an antitakeover tactic, as has been discussed today.

Today the class A shares continue in the Adolph Coors, Jr. trust and through rule 144 our class B publicly traded shares have grown to 34 percent.

This situation of dual class representation has allowed our company to prosper under family management for four generations. A mere $10,000 investment in 1873 has grown into a company of $1.4 billion in sales size in 1987. We've been able to endure prohibition which shut our company down for 20 years, but my great-grandfather reinvested his life's savings back into the company during those years such that no jobs were lost.

We have been able to survive intense competition. We have seen 800 brewing companies go out of existence since 1933 and today 96 percent of all beer produced in this country is consolidated in six brewing companies and some of those won't last out the decade.

The failures of those 800 brewing companies, by and large, were due to the inability of those companies to manage the huge debt burdens that are inevitable in lean years. The lean years came and they couldn't handle the debt.

We, as a matter of company policy, have never borrowed a dime. We reinvest our earnings for growth and I think that's unique among public companies. Some say even foolish. But we've been a successful survivor in a highly competitive environment because we've managed for the long term, not short-term earnings to hype our stock or to make ourselves an attractive takeover target.

Long-term preservation and growth of our shareholder value has been our focus and I think our founder's desire.

The contemplated one share/one vote legislation would restrict the trading of our shares over the NASDAQ NMS. In fact, we would have to be delisted to pink sheet trading. If you're familiar with pink sheet trading, and I mention that in my written testimony, which I trust will be entered into the record, Mr. Chairman.

The CHAIRMAN. It will be entered in full, yes.

Mr. COORS. The pink sheet situation is very slow. It's cumbersome. It is doubtful whether the process could keep up with the rather large trading volume our stock commands. It would likely depress shareholder value and the liquidity of our shareholders.

There is no effective market surveillance system in the pink sheet operation and so our shareholders would be exposed to potential of insider trading problems.

The NASDAQ NMS has provided a very efficient and controlled market for our shareholders—the initial secondary offering shareholders, the subsequent 144 purchasers, and the public at large. We have never disenfranchised anyone. We entered the market with full disclosure that the shares being offered were nonvoting.

Now we recognize that there have been some abuse and disenfranchisement of existing shareholders in some companies and we agree with the NASD proposal of last summer to prohibit trading of shares for any corporate action which would have the effect of nullifying, restricting or disparately reducing the per share voting rights of holders of outstanding classes or classes of common stock.

The NASD and, as said before, the New York Exchange are self-regulating bodies, but the SEC has attempted to bring them together into an agreement to establish policy to curb the abuse of disenfranchising certain shareholders. We encourage that process and we would hope that the Congress would as well.

Perhaps as a last resort Congress should consider, if all else fails through the existing mechanisms of the SEC, some type of enabling legislation. It would be our recommendation that that legislation be very specific, that it would not require one share/one vote per se

Since enactment of the federal securities laws, the number of public investors who directly own equity securities in this country has grown to over 47 million, and the additional number of individuals who own stock indirectly through pension plans, life insurance policies and other accounts exceeds 133 million.[96] These public investors have relied on a Congressional policy that links fair corporate suffrage to the trading markets for equity securities. An increasing number of publicly-held corporations have determined to break this link to foreclose takeover threats. Differing sets of listing standards have permitted companies to move from one exchange to another in a search for the least regulatory environment. The resulting competitive pressures felt by the exchanges and the NASD have caused a deregulatory crisis over stockholder voting rights, a crisis which ultimately may extend to other qualitative standards imposed on listed companies.[97] Although the SEC believes it has the authority to act,[98] Congress has provided no clear guidelines for the implementation of its fair corporate suffrage policy. The resulting lack of certainty could be harmful to corporate enterprises, the investing public and the markets Congress has sought to protect.

Substantial damage already has occurred, but that harm is inconsequential when future prospects are considered. Presently, only 200 of 6,500 publicly-held corporations have undertaken to break the link between voting and trading. One exchange official has predicted that "the floodgates will open."[99] Another commentator has warned that "eventually all companies will be controlled by some small, inside group; public stockholders will not have any role or significant voting rights" if the one share, one vote rule is taken away.[100] In the words of a former SEC Commissioner, we should "question the legitimacy of vesting so much of our nation's wealth in the hands of what would be self-perpetuating managements."[101]

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[96] NYSE FACT BOOK 59 (1987).

[97] See NYSE SUBCOMMITTEE REPORT, supra note 17 at 1. The states, which have historically exempted from registration exchange-listed securities based on the qualitative listing standards imposed, are understandably concerned about the erosion of those standards. See Warren, "The Status of the Marketplace Exemption from State Securities Registration," 41 BUS. LAW. 1511 (1986).

[98] SEC Rel. No. 34-24623 (Jun. 24, 1987).

[99] See Seligman, supra note 2, at 703.

[100] Vise, "John Whitehead on Securities Industry Issues," Wash. Post, Feb. 10, 1985 at G2, col. 5.

The idea of a federal corporation law has been suggested since the beginning of the Republic. James Madison recommended the idea during the Constitutional Convention.[102] Presidents Theodore Roosevelt and William Howard Taft promoted the idea in the early part of this century as a way to combat monopolistic practices.[103] In the 1970s, Ralph Nader and others urged federal chartering as a means to effect social reforms.[104] Congress has not heeded these calls.[105] Instead, it has chosen a course of restraint, supplementing state laws where they have proven insufficient to protect national interests. Because jurisdictional problems plagued state administrators in their efforts to fight interstate securities fraud in the 1930s, they implored Congress to adopt a law that would supplement their own.[106] Our nation's securities markets are beyond their reach and depend on federal protection. That protection need not preempt state corporation law. It should only condition the use of our securities markets upon the issuers' accountability to public stockholders through fair corporate suffrage.

This was Congress' intent in 1934, but that policy never took the form of a specific provision in the statute. The provision should mandate one share, one vote for all publicly-held common stock required to be registered under the 1934 Act, and should grant the SEC authority to adopt rules consistent with the fair corporate suffrage policy. Once in place, the voting rights inherent in publicly-held common stock, like disclosure, antifraud and other protective provisions in the federal securities laws, could not be waived by public investors. This measure will reestablish the linkage between power and responsibility. It will contribute to a needed perception of legitimacy.

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[101] Greenhouse, "Unequal Rights in Voting Stock," N.Y. Times, Mar. 19, 1985, at D2, col.1.

[102] See Schwartz, *supra* note 52 at 547, citing J. Madison, NOTES OF DEBATES OF THE FEDERAL CONVENTION 638 (1966).

[103] *Id.* at 547.

[104] *See e.g.*, NADER, GREEN & SELIGMAN, TAMING THE GIANT CORPORATION (1976).

[105] *See generally*, Brudney, "Corporate Governance, Agency Costs and the Rhetoric of Contract, 85 COLUM. L. REV. 1403 (1985) (governmental intervention may be necessary to restrain managerial discretion).

[106] *See generally*, Warren, "Reflections on Dual Regulation of Securities: A Case Against Preemption," 25 B.C.L. Rev. 495 (1984).

but be targeted to the disenfranchisement issue along the lines of the NASD recommendations.

In summary, our company has been able to prosper and survive hardship as a family managed business while providing equity to nonvoting shareholders. The NASDAQ NMS system is an efficient marketplace to trade our stock as a multiple class of stock, and it would be very damaging to our shareholders or those of the next Adolph Coors Co., the next entrepreneur that forms a family managed business, if the trading of these type of shares were disallowed.

Thank you, Mr. Chairman.

[The complete prepared statement of Jeffrey H. Coors follows:]

TESTIMONY BY JEFFREY H. COORS

PRESIDENT, ADOLPH COORS COMPANY

ONE-SHARE/ONE-VOTE

SENATE BANKING COMMITTEE

MARCH 17, 1988

Good morning. I appreciate your time in hearing the Adolph Coors Company's views on the so-called one-share/one-vote issue.

It is the position of Adolph Coors Company that legislation restricting the trading of multiple classes of stock with disparate voting rights on the national exchanges or automated quotation systems would be inappropriate. However, if the Securities and Exchange Commission is unable to prevent the disenfranchisement of shareholders by the unilateral action of management, specific legislation may be warranted to curb these types of abuses in this specific area.

This testimony describes the benefit to shareholders, companies and the national economy by the ability to utilize multiple classes of stock with disparate voting rights in certain situations. This has encouraged the entrepreneurial spirit of our great country. The history of Adolph Coors Company is a case in point.

This testimony also reviews the need, if any, of Federal legislation and makes specific recommendations to curb abuse while retaining the free market choices currently available.

BENEFITS OF MULTIPLE CLASS/DISPARATE RIGHTS

There are legitimate, beneficial reasons for some companies to offer investors multiple classes of stock with disparate voting rights. When done in an initial public offering, in certain types of mergers and acquisitions, and in certain corporate restructuring, the desires of present owners and future owners can sometimes be met best through the use of separate classes of stock.

There is a different issue altogether, with different regulatory needs, when companies alter the rights of some existing shareholders with the sole purpose of preventing acquisition or ensuring management without a proper shareholder vote. Such disenfranchisement of some shareholders by others is a valid issue to address, but does not preclude the beneficial use of multiple classes of stock.

One beneficial use of multiple classes of stock is in a merger or acquisition. The acquiror may not desire to dilute voting control and the acquired may be fully agreeable to giving up voting control for a share in the merged company. Assuming both enter the agreement with their eyes open and both company's shareholders agree to the action there is no reason to prevent the merger or to require it be done on the basis of equal voting rights. To restrict the ability of these shares to trade on national exchanges would limit the flexibility of companies to structure transactions which are beneficial to the enterprise and its ownership. We believe that the only proper federal limitations on this type of transaction is to assure that adequate disclosure has been made.

A second beneficial use of multiple classes of stock is as a method of allowing an entrepreneur or family-managed company to maintain control while raising capital from the public equity market. The entrepreneur is typically vital to the success and growth of his ideas from a seed thought into a major business. Debt financing planning can bury a company. Equity financing is often the key to success, but if he, the entrepreneur, were forced into giving up control in order to raise capital in the equity market, there could be little incentive to grow the company.

Some entrepreneurs, after developing a business, wish to leave the control of the company in the hands of their children. Much of the industrial growth of our nation has been through family-managed businesses, in which each succeeding generation builds upon the success of the prior generation. Typically, family-managed companies have different priorities than professionally-managed ones. Family managers are less concerned for the short run and are willing to take extraordinary risk for the long-term success of the venture.

Family companies have needs for capital, for growth and inheritance tax obligations which often are best met in the public equity market. If they were prevented from using multiple class or disparate voting share mechanisms, the family's only option would be to sell their company. This would eliminate a great strength of the American free enterprise system and, I believe, will ultimately severely dampen the prosperity of our nation. So long as equity, when issued, properly discloses voting rights, I see no reason for government intervention.

ADOLPH COORS COMPANY'S HISTORY OF DUAL CLASS STOCK

Adolph Coors Company is a case in point. Our company was founded in 1873 by my great-grandfather. His wishes were to maintain control of the enterprise within the family management while providing equity participation to the family members not active in the business. This has resulted in a dual class of common stock. Class A stock is fully voting and Class B has limited voting privileges. Our Company has 1,260,000 shares of voting stock, Class A, authorized, issued and outstanding.

There are approximately 36,000,000 shares of non-voting stock, Class B, outstanding. Our Articles of Incorporation require that identical dividends be paid on shares of each class. Holders of Class B shares are required to vote, under Colorado law, on certain important matters affecting the Company, such as changes in its capital structure.

Our usage of a class of non-voting common stock has nothing to do with recent tender offer tactics which have drawn so much attention. Some historical information about our Company will illustrate why non-voting common stock was issued many years ago. The origins of our two classes of stock are found in a trust established by my great-grandfather, Adolph Coors, in 1922. Of his six children, only Adolph Coors, Jr. had sufficient interest and ability to operate the family-owned business which, at that time, operated under the adverse circumstances of prohibition. The purpose of the trust was to place control of the business and a portion of its ownership in the hands of Adolph Coors, Jr. while allocating the remaining ownership equitably among the other five children.

Class A shares currently are held by the Adolph Coors, Jr. Trust, the Trustees of which include two sons, one daughter, and two grandsons of Adolph Coors, Jr. The ownership of Class B shares currently is dispersed among descendants of Adolph Coors who are involved in management of the Company, other descendants who have no active role in management, and the general public. Approximately 34 percent of the outstanding Class B shares are owned by the general public. There are approximately 9,000 of these public shareholders.

In 1975, in order to fund estate tax obligations, a secondary public offering of 4,100,000 Class B shares was made. These were the first shares of Adolph Coors Company to be held by the public. None of the proceeds of the offering directly benefitted the Company. The number of shares owned by the public has grown from 4,100,000 in 1975, to over 12,000,000 through subsequent Rule 144 sales. Obviously, the non-voting nature of Class B shares has not deterred the public from acquiring and trading in Class B shares, nor has it decreased the value of these shares.

We mention these facts in order to stress that our Company's usage of Class B shares developed as a family estate planning matter and had nothing to do with corporate tender offer tactics currently under scrutiny.

The Coors family historically has reinvested most of the earnings of Adolph Coors Company back into the Company's operations.

The Company has never borrowed funds to finance its operations, but has limited growth to that allowed by internally-generated funds. This type of conservative fiscal management is virtually unique among major corporations in America. But we have witnessed over 800 brewing companies fail since 1933, most because they could not manage the debt burden during inevitable lean years. Fierce competition, consolidations, mergers and failures have brought our industry to the point where 96% of all production is by 6 companies. Some of those companies will not last in their present form through this century.

We are a survivor, but it is only because we are able to manage our business for the long term. This is the preservation and growth of shareholder value as the founder desired.

Had my great-grandfather been required to issue voting shares to capitalize the Company or handle estate problems, we would have most likely been one of the 800 casualties. You might say, "So what." We would have been acquired at some point; stockholders would have reaped a cash reward and the volume of our Company absorbed in a bigger operation. Who would have suffered? Maybe no one.

But what if more companies had managed their businesses like we did? There certainly would be more than a handful of viable competitors today.

SHAREHOLDER IMPACT BY RESTRICTING MARKETS

Ours is only one case in point. There are numerous reasons why dual class or disparate voting shares are legitimate financing mechanisms. Prohibiting these types of shares on the national exchanges or automated quotation systems would restrict the ability of many companies to raise equity financing. Companies desiring to trade securities other than one-share/one-vote would only have access to "pink sheet" transactions which would most likely depress stock prices and liquidity. Those shareholders who wish to own and trade in these securities would be severely impacted by not having an efficient market system such as the exchanges of the NASDAQ NMS or regular OTC systems.

The difference between the NASDAQ NMS list and the regular NASDAQ list is that NMS issues are traded on what is known as the "real-time quotation system." Under this sophisticated system, trades are reported electronically throughout the country within 90 seconds of the time they occur. This promotes market liquidity and greatly aids the NASD's market surveillance system in policing the trading of all NMS issues.

The regular NASDAQ issues are traded without the aid of the real-time quotation system. The trades are based on the last bid and ask prices for the previous day which are updated on an interbroker basis, but transaction reports - which enable the NASD to monitor unusual trading volume are not available during the day.

Banning such shares from these efficient electronic systems, would relegate trading in these shares to the so-called "pink sheets." The market likely would diminish because trades could not be made on either of NASDAQ's two electronic systems. Prices quoted in the pink sheets depend on the mail for updating. These quotations are not considered firm. The NASD requires a broker to make calls to three brokers to obtain the best execution for this client. Brokers do not report volume. The NASD obtains information concerning trades when a broker undergoes a periodic audit. It is an inefficient system and is difficult to monitor.

While no one knows for sure what the effect might be of being "down listed" from NMS status to the "pink sheets", one would certainly expect a decline in the number of market makers, and thus, a decline in market liquidity. One would also expect a decline in the number of shares traded daily. Currently there are over 27 market makers in our Class B stock. Trading volume frequently exceeds 100,000 shares per day. One would strongly suspect under "pink sheet" circumstances that a decline in the market price would result, severely penalizing our shareholders.

These adverse effects can be generalized into two categories. The first category is the direct effect on shareholders in the form of less market liquidity and, probably, lower share prices. The second category is the effect on the market mechanism. A company of our visibility and investor interest probably would continue to generate considerable trading. It is our understanding that the "pink sheets" system would be strained by such trading volume. More importantly, the protection provided by the market surveillance of the real-time quotation system would be lost, exposing shareholders to insider trading abuses. Given recent insider trading scandals and the market crash of October 1987, we are astounded that Congress would seriously consider legislation which would make it more difficult to monitor the trading of highly visible shares such as ours.

JUSTIFICATION FOR FEDERAL ACTION

Federal regulation of corporate governance has little precedence. This area has historically been a prerogative of the states.

Almost all state corporation laws permit shareholders to adopt capital structures under which some shares or classes of shares have greater voting rights than others. Some states have controlled share acquisition statutes that limit the exercise of voting control by an acquiring investor until the other shareholders have voted to permit the exercise of such control.

Any Federal law requiring prescribed capital structures (one-share/one-vote) or imposing Federal acquisition standards as a condition of trading in the national capital market is an unwarranted intrusion into states' rights.

There is a contract, or relationship, between shareholders and the company in which they invest. Where shares have been issued under a registration statement which sets forth the specific voting rights of the shareholder, the shareholder understands his or her rights and invests accordingly. This relationship should not be disrupted by the Federal Government.

Legislation should not be contemplated on the theory of imposing a more democratic process on corporate governance. One-person/one-vote for good representative government does not equate to one-share/one-vote, but more closely to one-shareholder/one-vote. The fact is there are beneficial and legitimate instances when both shareholders and companies agree to disparate voting rights among shareholders and no Federal regulation should preclude that.

RECOMMENDED ACTION

It is recognized that there has been limited abuse of shareholder rights which should be addressed. I recommend that the SEC work with the NASD and the exchanges to assure proper control of the abuses. Last summer, the NASD proposed corporate governance guidelines which would curb the abuses. The NASD proposal would prohibit inclusion in NASDAQ of issues that "would have the effect of nullifying, restricting, or disparately reducing the per-share voting rights of holders of an outstanding class or classes of common stock of such issues." The NASD proposal prohibits the disenfranchisement of existing shareholders rather than prescribing any specific capital structure. We believe this is the correct approach. Capital structures which were in place prior to May 15, 1987, would be grandfathered under the NASD proposal. The NASD proposal permits the legitimate variations of unequal voting rights. These variations would be limited to:

- o Shares with unequal or no voting rights issued in a registered public offering where all facts connected with the company's capital structure are clearly spelled out to prospective investors in the prospectus; and
- o Shares with unequal or no voting rights issued in connection with a merger, acquisition or recapitalization where the

exchange of shares is accompanied by detailed proxy material describing the unequal or no voting rights.

There is concern between NASD and the exchanges that uniform corporate governance rules would eliminate the historical differentiation between them and thereby threaten their existence. This has been a factor in preventing agreement between them and the SEC. However, it is possible and all efforts should be made to reach an agreement and to manage any perceived abuse of shareholder voting rights through the current authority of the SEC.

Should this fail, then the Congress should consider further enabling legislation. This legislation should not give the SEC a free hand in establishing any corporate governance regulation it sees fit, which might change from time-to-time based on changes in administrative policy. Enabling legislation should specifically empower the SEC regulation to prevent changes in shareholder voting rights which have the effect of nullifying, restricting or disparately reducing the per-share voting rights of holders of an outstanding class or classes of common stock as proposed by NASD. The SEC should be prevented from any regulation which would require prescribed uniform voting standards (one-share/one-vote) for all publicly traded stock and all current capitalization structures should be grandfathered.

CONCLUSION

It has been 115 years since our Company was founded. It has been 29 years since the Adolph Coors Company adopted the capital structure of voting and non-voting shares. It has been 13 years since our secondary public offering of non-voting shares. All this time, management has kept its focus on survival in a fiercely competitive industry, on reinvestment

for the future, and on long-term growth, rather than on short-term tactics which are designed to counteract takeover efforts. The number of breweries in the United States has declined from over 800 sixty years ago to a few major brewing companies and an assortment of smaller breweries. We have managed to protect and enhance the employment of 10,000 employees, have continued to play an important role in community affairs, and have generated hundreds of millions of dollars in taxes for Federal, state and local governments. Our stock has been actively traded in the NASDAQ NMS since 1975. It just does not follow that non-voting shares are an evil in these circumstances.

Similar stories can be told about entrepreneurial companies that depend on management by the "idea people" who started the companies. In those instances, public shareholders chose to invest in their companies and place their trust in management. These shareholders believe that their investment will out perform other investment options. Their faith demonstrated by continued investment is evidence that they accept the risk and rewards. Multiple class shares have proven valuable to the U.S. economy.

The **CHAIRMAN**. Thank you very much, Mr. Coors.

We're going to do this alphabetically, so I'm going to call on Mr. Hechinger and then Mr. Sommer and then finally Mr. Troy.

Mr. Hechinger, go ahead, sir.

STATEMENT OF JOHN W. HECHINGER, CHAIRMAN OF THE BOARD, HECHINGER CO., LANDOVER, MD

Mr. **HECHINGER**. My name is John Hechinger and I'm chairman of the board of Hechinger Co. I welcome this opportunity to testify.

Congress has historically had an interest in promoting the development of small American businesses because of the economic and social benefits which follow such development. Hechinger, a publicly held company since 1972, is a business which in 1983 adopted a capital structure with disparate voting rights in order to raise additional capital for expansion without sacrificing the continuing management philosophy which has been the hallmark of our success since the earliest days.

Proposed amendments to S. 1323, which could prohibit the trading of Hechinger securities in the national securities markets, would be disastrous for us. Such legislation would cause serious disruption and confusion for Hechinger stockholders, employees, and others who have come to rely on the stability provided by our current capital structure.

As of March 1988, Hechinger operated 71 specialty retail do-it-yourself home center stores in the District of Columbia, Maryland, Virginia, Pennsylvania, North Carolina, South Carolina, Ohio, New Jersey, New York, and Connecticut.

In 1983, Hechinger stockholders approved, after full disclosure in a proxy statement filed pursuant to the SEC, a plan of recapitalization and won by a vote of 71.5 percent of the then outstanding shares with less than 7 percent being voted in opposition to the plan.

Under the terms of this reorganization, the existing common stock was designated class B common, and a new class A common stock was created as a dividend to class B, which therefore in no way diluted the voting power of the then stockholders. Class A and class B shares are identical in all respects except the class A stockholders have one vote per share and greater dividend rights and class B stockholders have 10 votes per share.

The current dividend rate on class A shares is 16 cents and class B it is 6.4 cents. The closing price of class A shares on March 11 was $19.25 and class B was $19.50, demonstrating the small differential the marketplace places on the lower voting characteristic of class A shares and partially answers, in my respect, Senator Shelby's question.

The **CHAIRMAN**. I think it was Senator Graham who asked that question. Isn't that right, Senator Shelby.

Senator **SHELBY**. I don't remember.

The **CHAIRMAN**. It doesn't matter. At any rate, you gave us a good answer.

Mr. **HECHINGER**. Hechinger is actively traded in the NASDAQ NMS market and 50 percent of our class A shares, the lower voting shares, are held by large, sophisticated institutional investors like J.P. Morgan.

Hechinger management is not an entrenched and unproductive management that raiders claim is the reason companies go to dual classifications. In fact, Hechinger profits have steadily risen and we just yesterday announced our 52d consecutive quarter of increased earnings.

As you see, Hechinger is a growing, dynamic company. You are witnessing at this very moment retail companies such as Federated and Stop and Shop whose most probable defense to a hostile takeover is incurring burdensome debt. Thus, in the event of economic downturn, making it difficult to weather this change.

As Hechinger has grown from a small private company into a large and growing public company, it has also successfully met the challenge of preserving the dynamic, energetic leadership that keeps us, to use our slogan, the world's most unusual lumberyard. This is readily apparent in our employment record. With the advantage of additional capital, Hechinger by expanding into five States has become a one-company jobs program, by adding over 6,300 new jobs in the last 5 years alone. This is a remarkable achievement. Hechinger's family atmosphere has led to exceptional stability among its store management personnel. Each of Hechinger's 71 store managers have an average of 15 years experience with Hechinger. Hechinger's 213 assistant managers have an average of 8 years with the company. In this age of job mobility and competition for employees from our competition, this is an enviable record. This seniority is only possible because people feel a part of a stable enterprise and know that they can rely on Hechinger to be here tomorrow. The stability, experience and commitment of our store management personnel provides essential encouragement and motivation for management and nonmanagement employees alike. When employees see that there is a future for them, they care more about how they do their jobs and this contributes to making us the successful company that we are. Our remarkable employment record would not exist if the future had been uncertain because of vulnerability to a hostile takeover attempt or top-level management instability.

One of the most significant arguments for the fairness of our two classes of stock is that we have been back to the market three times since 1983 raising millions of dollars, and these underwritings were all in the lower voting class A stock alone and each of the offering was oversold. As I said before, the great portion of the purchase of the offerings was done by very sophisticated institutional investors.

Much has been said that Government regulation of stockholders' voting rights should remain in the domain of the States and not be invaded by Federal legislation. I'll shorten my testimony by associating myself with that position.

I would also like to take this opportunity to point out what I believe is a confusion between stockholder democracy and political democracy. We have constitutional rights to vote. The foundation of our free market system is not based on a single vote for every share of stock. Those who argue for the analogy between one man/one vote and one share/one vote misunderstand the concept of the corporation as an economic institution, not a political institution. We should not confuse political voting rights with privilege arising from a contractual business relationship.

GRANDFATHERING CLAUSE

Finally, I'd like to point out that, should Congress—I have been speaking not for Hechinger Co. alone but in general and I mean for the good of all markets—but should Congress determine to enact legislation mandating one share/one vote, I strongly believe that any such legislation must provide a clear grandfathering clause that will protect corporations that have adopted capital structures with disparate voting rights in good faith before any such legislation was contemplated.

Hechinger has effected a stock split or a stock dividend in every year since 1978. Preexisting capital structure must be grandfathered in their entirety in order to avoid serious disruption to the existing financial plans of grandfathered companies.

For instance, a restriction on Hechinger's ability to issue dual classes of additional shares of common stock would prevent future stock splits and stock dividends and significantly impair our ability to create value for our stockholders.

For example, 100 shares of class A, the low voting shares, in 1983 were worth $1,392. Today, those 100 shares, due to splits, are equivalent to 156 shares and are worth $2,964. Any grandfather provision should make it clear that a grandfathered company will be permitted to issue additional authorized shares and also to increase the number of authorized shares and to issue those shares.

Our dual-class structure serves the long-term interest of our stockholders. We believe very strongly that there are behemoth corporations and corporate raiders out there which would attempt a hostile takeover if our dual capitalization structure were eliminated. The real threat in America to industry today is the elimination of entrepreneurship for the great god "Bigness". We are proof that a company growing from inside can be a success on its own without joining a conglomerate.

The bill in its current form will destroy our independence. Thank you.

The CHAIRMAN. Thank you very much, Mr. Hechinger.

Mr. Sommer.

STATEMENT OF A.A. SOMMER, JR., FORMER SEC COMMISSIONER

Mr. SOMMER. Thank you very much, Mr. Chairman.

Mr. Chairman, members of the committee, I would like to thank you for the opportunity to appear here this morning on this very important issue.

As you correctly stated, Mr. Chairman, I'm a former SEC Commissioner. I am practicing law in the city. I represent corporations that have an interest in this, but I am appearing strictly on my own recognizance, if you would, because of my convictions with regard to this.

I was also cochairman of the New York Stock Exchange committee that advised the modification of their one share/one vote standard. While I am not testifying for that committee, I think nothing that I say is inconsistent with what that committee recommended.

This issue is of transcendent importance and it becomes even more important because of the confusion that I think has attended it as time and debate have gone on. It poses some very fundamental Federal-State relationship issues and, besides that, I think it has a profound impact potentially upon the economics of this country.

As I will indicate further on in my testimony, I think it may have an impact upon the willingness of entrepreneurs to seek equity capital as opposed to debt. As recently as Monday, in a front-page article in the Wall Street Journal, we were reminded of the potential hazards that exist to American enterprise and the American economy as a result of the buildup of corporate debt.

Issues like this tend to get confused as time goes on and I would like to go back to a few fundamentals.

STATES HAVE ALWAYS DEALT WITH THIS MATTER ADEQUATELY

Philosophers have spoken of the fact that history is a great teacher and that we ignore history at great risk, and I think that is true. The history of this issue goes back 200 years and 200 years it has been a matter that has been dealt with adequately by the States and uniformly by the States, with the exception of the instances that my good friend, Bob Monks, mentioned—incidentally, I would eschew his designation of me as a scholar. In any event, with the exception of a couple of instances where there were terrific abuses with regard not only to voting rights but other matters as well, and the Congress chose in effect to preempt State corporate statutes in large measure and impose a broad system of regulation upon registered public utility holding companies—of which there are only twelve—and investment companies—with those exceptions, this has been a matter that has been dealt with by the States uniformly for 200 years and the Federal Government—wisely, in my estimation—has kept its hands off it.

If you go back to the early days of the republic, you will find the common method of corporate governance was not one share/one vote. As a matter of fact, more common were all kinds of variations which were tolerated by the States for reasons I'll get into in a moment.

As Senator Sanford pointed out, the Supreme Court as recently as last April reaffirmed this history. While he quoted from the Courts' opinion, I'm going to quote again.

> No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.

They said:

> State regulation of corporate governance is regulation of entities whose very existence and attributes are a product of State law. It is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.

Those, in my estimation, are words that should be not lightly treated by either this Congress or the SEC.

Why have the States allowed broad latitude to corporations in determining the allocation of their voting rights? It seems to me the answers are simple. They recognize the enormous variety of corporations, the enormous variety of needs, times, circumstances, capital requirements, and in order to accommodate that tremendous variety of needs that corporations have, they felt it was wise to accord them the greatest possible latitude and flexibility in determining what their corporate structure should be.

The fact of the matter is that they recognized, in my estimation, that it was essential in many instances that corporations be permitted to put the responsibility for the control of the corporation in the hands of management or a small family group simply because of the fact that otherwise you wouldn't have the opportunities afforded to the public to share in the equity of those corporations.

I was at a meeting at the Harvard Kennedy School a few years ago in which a very successful New Hampshire entrepreneur got up and said:

> You know, I'd love to go public. I think I have a great company that should be permitted to get into the hands of the public, but I'm not going to do it, because if I sell stock, the next thing you know somebody is going to take me over and break up what I spent my lifetime developing.

That's why the belief was in the States that corporations should be permitted to write their own ticket with regard to the matters of corporate governance.

Shareholders, after all, are free to buy and sell stock. We hear great talk about such things as coercion of shareholders in recapitalizations. The fact of the matter is, in every case where a corporation has been recapitalized with a change in the allocation in the voting power, the shareholders have had to vote for it. That is required by every State law. It is not something that is imposed or inflicted upon minority shareholders by management acting unilaterally.

As was evident from what Mr. Hechinger said, invariably there has been overwhelming shareholder support for the change in the capitalization.

Now people may very well ask, why is it that shareholders would vote in this fashion which may deny them a takeover premium? Well, I think the notion that shareholders want to be in a position to be taken over, to realize the takeover premium, is not substantiated by studies that have been made.

In a survey by Louis Harris and Associates last year, 60 percent of the individual shareholders surveyed thought hostile takeovers did more harm than good. In another survey by Penn & Schoen Associates, 77 percent of those who owned stock were of the opinion that takeovers should be harder and less frequent and 66 percent of them thought the state should continue to pass laws making takeovers more difficult.

This is the reason why, in my estimation, shareholders have voted overwhelmingly for these recapitalizations. They are long term in their viewpoints. They are not concerned with immediate takeover premiums.

As I have indicated in my testimony submitted to the committee, which I would ask be incorporated in the record——

The CHAIRMAN. Without objection, it will be included.

TIMES HAVE CHANGED

Mr. **Sommer**. The fact of the matter is that the only source of a broad restraint upon corporations with regard to a capitalization structure providing other than one share/one vote has been the New York Stock Exchange rule. That was originated in 1926 and, as the subcommittee that I cochaired indicated in its report, times and circumstances have changed radically since 1926. You had no SEC then. You had no requirement of full disclosure with regard to proxy solicitations. You had no institutional investors in the quantities we have them now. You had no independent directors. It is a changed world and the protections that the Exchange thought it was giving to shareholders at that time really have become unnecessary in view of all the reforms that we have had.

The general notion that in some fashion one share/one vote to corporations should be analogized one person/one vote in political life breaks down by its own terms. Senator Armstrong spoke of the possibility—beyond tenability if you will—of a majority of the Senators agreeing that all the power would be exercised by six of them. Well, Senators become Senators because they want to influence policy and if they are denied that opportunity through that kind of a tactic, they have nowhere to turn.

But shareholders who don't like the capitalization of a company don't have to invest in it. If the capital structure of a company is changed, they don't have to maintain their investment. They can sell their stock. As a matter of fact, the evidence would indicate that with Mr. Coors and Mr. Hechinger the shareholders have had good reasons to be contented with their investment, notwithstanding their variations on one share/one vote.

Professor Ruback talks of going into a restaurant and finding that your favorite dish is no longer on the menu, leaving you with a bunch of unpalatable choices. You don't have to eat in that restaurant. You can go next door where you find your favorite dish. And the same thing is true of investing in corporations. People don't have to stay invested in corporations that change their capital structures. They are perfectly free to sell their stock in the market.

Now the question has been raised as to whether these measures adversely impact shareholders. The SEC has done studies—several of them as a matter of fact—in one case, the answer came out wrong so they did another one—showing that there had been some impact upon the prices of stock. There was an impact of less than 1 percent the day after the announcement was made that a company was going to recapitalize, less than 1 percent. In other words, less than a quarter of a point on a $25 stock.

They didn't study what the situation was a month or 6 weeks later. I happen to have been associated with a company which announced a recapitalization. Their stock went down the next day and within a week it was worth more than it was at the time of the announcement. I would suggest there is no evidence whatsoever that's credible establishing the fact that shareholders are harmed by these recapitalizations.

In closing, I would urge that Congress listen to the voices of history rather than the clamor of opportunists, that it recognize the total absence of any evidence that the ability of corporate shareholders to shape the division of voting power among themselves has harmed either them or the community.

I would say to you, Mr. Chairman and members of the committee, I'd take Mrs. Reagan's advice and transpose it to this arena and to those people who would try to wipe out the flexibility that corporations presently enjoy, I would simply say "no."

Thank you.

[The complete prepared statement of A.A. Sommer, Jr., follows:]

TESTIMONY OF A. A. SOMMER, JR.
BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE
100th CONGRESS, SECOND SESSION

MARCH 17, 1988

Mr. Chairman, members of the Committee. I wish first to express my appreciation to you for the opportunity to appear before you this morning to discuss this extremely important topic, and I congratulate you for according it a hearing during a time when the Senate and this Committee are confronting so many topics of enormous national and international importance.

I was the co-chairman of the New York Stock Exchange Subcommittee on Shareholder Participation and Qualitative Listing Standards that in January 1985 recommended that the Exchange change its listing standard that barred the listing of the stock of an issuer which had classes of common stock with different voting rights. My presence here today has nothing whatsoever to do with that assignment long ago completed. My presence here is simply the result of your invitation that I appear and the strong convictions I have about the subject matter of this hearing.

The proposals to impose a one share/one vote requirement on substantially all significant publicly held companies well deserves the critical attention you are giving them. These proposals to impose a federal rule, either through legislation or regulatory fiat, that would shoe-horn all significant publicly held corporations into a single pattern would overturn two hundred years of established state-federal division of jurisdiction over corporations -- ironically, less than a year after the Supreme Court resoundingly reaffirmed that historic division. Congress (and the SEC) are being asked to undo two centuries of established law -- why? Basically for no reason other than to accommodate those who fear the very shareholders they purport to represent may determine to repel them by adopting measures that may thwart their ambitions.

Historically it has been state law that has governed the distribution of voting power among contributors of capital to corporations. The singular characteristic of the state laws governing these matters -- and I should add that every state permits this flexibility -- has been the freedom accorded entrepreneuers, contributors of capital, shareholders, promoters and others concerned with the organization and structure of corporations to fashion the relationship between capital and control in the manner best suited to the enterprise, the times in which it exists, its needs and those of its many constituents, and efficiency in the use of its resources. Through the use of voting structures that depart from the one share/one vote practice, it has been possible for talented entrepreneuers who have not wished to risk control being untimely snatched away from them to raise vast amounts of capital which has been utilized to the great benefit of our economy. Without the opportunity of shareholders to fashion the corporate charter in a manner to protect control it is not an exaggeration to suggest that many of these enterprises would never have flourished and grown in the fashion they have, for the founders and entrepreneuers would have been chary in seeking outside equity capital.

It is well to bear in mind that the one share/one vote practice is not graven in stone or written upon an eternal tablet. The only rule today that mandates that corporations not depart from the one share/one vote standard is not an act of Congress; it is not an enactment of any state; it is not a rule of any federal or state agency. The only mandate is in the rules of the New York Stock Exchange -- a rule that presently applies to only about 1,700 of the more than 10,000 corporations that may be said to be publicly held.

That rule has, in my estimation, served well the public interest over the years. However, as is outlined in the statement accompanying the recommendation of the Exchange's Subcommittee on Shareholder Participation and Qualitative Listing Standards, circumstances since the adoption of the policy in 1926 have changed radically. In 1926 there were no legally mandated standards of disclosure; there were no proxy rules to assure that shareholders had the

The **Chairman**. Thank you, Mr. Sommer. There's no doubt where you stand.

STATEMENT OF RICHARD H. TROY, CHAIRMAN, AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

Mr. **Troy**. Mr. Chairman and members of the committee, as an active participant in the one share/one vote dialog over the last year or two, I find the question often asked: What's wrong with one share/one vote? And the answer is, there's really nothing wrong with one share/one vote as a voluntary corporate practice. It is the predominant voluntary corporate practice in America today and while we in the American Society of Corporate Secretaries endorse this voluntary practice, we find ourselves much more insistent in endorsing two main values which can be found either in simple corporate structures or in complex capital structures; namely, the values of understandability—does the stockholder understand what he has?—and the values of fairness—is the stockholder somehow being cheated?

The problem obviously arises when somebody comes along and says, "Hey, let's take a good voluntary practice and let's convert it into a rule of mandatory law." And in such situations as I assume you've seen before in your experience, a host of problems arise. Hence, no surprise that they would arise here.

Consider the converse of the question; namely, what is wrong with variations from a one share/one vote rule to attain desirable objectives? And the answer is, really there's nothing wrong with what a Coors has done or a Hechinger has done or a General Motors has done in acquisitions, what Hershey has done to achieve the charitable purposes of a trust, and there's nothing wrong in a wide variety of other variations from one share/one vote which meet the needs of stockholders and the corporations they own.

And I don't think you're going to find a witness who would seriously dispute that proposition. I don't think you've heard it this morning, unless you find someone who is wedded to the extreme view that stockholders have no right to pick their own capital structures, no right to govern their own affairs, and no right to say no to the first person who makes a pass at buying their business.

So the issue really shifts to how we can assure stockholder rights without abrogating them with a broad rule.

BAD POLICY

Let me turn then to several of the reasons why it would be bad policy to convert the voluntary practice of one share/one vote into a rigid rule of law binding on all corporate structures. There are many reasons for this. Since time is limited, I would like to allude to only seven of them.

First, such a rule would, of course, prohibit legitimate and useful business structures and transactions. Many of them have been referred to here this morning. I don't want to repeat them. I should like to submit an exhibit illustrating other corporate practices and structure. I know such groups as the Alliance for Corporate Growth, for instance, have a wealth of information which would be helpful to the committee on this subject matter.

In addition to the examples of individual corporations, we must consider that the imposition of a broad Federal rule mandating one share/one vote may prohibit or at least seriously call into question a wide variety of generic and accepted corporate practices, such as cumulative voting, which is designed to protect minorities; Supermajority provisions for mergers and charter amendments and the like, again, provisions designed to protect the minority; Staggered boards of directors, stockholder rights plans, poison pill plans, voting rights and conversion rights of preferred stock in debt holdings; even certain trust arrangements, standstill arrangements, long-term proxies, even certain partnership forms of business. And businesses and industries which are subject to regulation as to their ownership because they happen to be in shipping or communications or defense or in banking.

And it would inhibit creative capital-raising alternatives which may be driven by desires such as avoiding adding to the debt burden of a corporation, avoiding diluting the voting power of existing stockholders, or dealing with everchanging tax laws.

State law has traditionally provided a laboratory for experimentation and evolution in corporate law. This would now be severely circumscribed if a rigid federal rule were imposed upon the capital of all publicly held corporations.

Our second basic reason for not adopting a Federal rule mandating capital structure is conflict with State law. Some of the witnesses this morning, and the Senators, have quoted the Supreme Court on this subject. A Federal rule on capital structure would create varying degrees of conflict with substantive State rights and the arrangements between stockholders and their corporations. In some situations it would create direct preemption. In others, simply preemption in effect.

In addition to all the individual cases of corporations and to the generic practices I've just referred to, consider the following three additional situations: Corporations currently having disparate voting rights would frankly be required to alter their capital structures or be delisted. The stockholders would then have to choose between their right to have their stock publicly traded and their State law rights.

A second consideration. Boards of directors are charged under State law with fiduciary duties to protect their stockholders in a variety of difficult situations, which may include insolvency, reorganization, restructure, change of control. And a Federal law on capital structure would conflict with this duty where directors would otherwise take steps to alter capital structure to achieve the best interests of all the stockholders in transactions which a reviewing court would uphold as a prudent exercise of fiduciary duty.

Third, and quite obviously, some states have adopted control share statutes, such as the Indiana statute upheld by the Supreme Court. A Federal rule on capital structure would be a direct preemption of such activity.

A third reason for not creating such Federal corporate law—and I think we ought to be clear about this—is that it would destroy the current balance of federalism. Where should we then look for guidance on corporate law and structure? To the States where we have been accustomed to looking or to the Federal "who"?

Moreover, it would destroy our present understanding of the American publicly held corporation by setting up priorities and purposes which are at variance with what otherwise would exist under Federal law.

A fourth drawback of a preemptive Federal law would be to further clog the Federal courts. A Federal statute prescribing capital structure simply creates another Federal cause of action. And if you compeleted the basis of that cause of action you can draw into the Federal courts disputes which would otherwise stay in the State courts.

A fifth problem with a Federal rule on capital structure is that, quite simply, it usurps the rights of stockholders. And that's a pretty serious thing to do in the name of corporate democracy—to usurp the rights of stockholders to determine their capital structures and their voting rights. It would preclude stockholders from voting on matters, whether they're mergers, charter changes, exchange offers, which would involve an alteration of their current voting rights.

About 10 days ago, the Supreme Court of the United States in Basic against Levinson cautioned all of us not to treat stockholders like nitwits. And that's their terminology, not my terminology—not to treat them as nitwits by assuming that stockholders could not understand and therefore need not be told of developments pertaining to the preliminary negotiations for mergers of corporations in which they own stock.

Similarly here, a Federal rule prescribing capital structure in a manner now explicitly disparaged by the Supreme Court would paternalistically treat stockholders as incapable of understanding what they are being told and incapable of making their own investment decisions.

A sixth and somewhat dramatic reason not to impose a Federal rule binding all marketplaces is that, ironically, it would create a startling new and effective antitakeover device. Perhaps the "doomsday machine" of all the antitakeover devices yet devised. Because if all markets were subject to a rigid one share/one vote rule, then any target company could decide to issue an offending security, thereby making it illegal under the rule for any further transactions in its common stock using any means subject to Federal market regulation.

This would produce either an end to the trading in its stock or chaos or at least a suspension in trading until a corporation could devise further defenses. While it may not be likely that a responsible board of directors would choose to invoke the "doomsday" scenario, the matter cannot be prejudged and, indeed, the particular circumstances of an unfair offer might justify or even urge a period of halt or of chaos in order to permit a corporation to find a better deal for all of its stockholders.

As a final item under the heading of reasons not to convert one share/one vote into a mandatory rule, there simply is no need. The prolong dialog before the Securities and Exchange Commission has served to winnow away much of the rhetorical chaff which initially surfaced in the one share/one vote debate. As the chaff has been blown away, the issues which have begun to emerge are the much more particular issues focusing on the possibility of stockholder disopportunity to cast informed votes on such matters as the capitalization of their company; independent directors were virtually unknown; institutional ownership was miniscule (8% in 1933 versus probably more than 50% now). To suggest that this Exchange-originated rule, commendable as it may have been when adopted more than six decades ago, should now in vastly different times, be made a mandate upon all significant publicly held corporations simply because it served well a segment of the corporate world in different times is simply bad history, bad law, and bad logic.

Throughout the history of corporations in the United States there have been innumerable variations in the relationship of contributions of capital and capacity to vote on affairs of the corporation. In fact, in the early days of the Republic and well into the last century one share/one vote may have been the least common of the options. During those days it was not uncommon for corporations to accord one vote to each shareholder, regardless of the number of shares held, or to limit the number of votes that any shareholder might cast, regardless of his contribution to capital. These and countless other variations were seen by those who incorporated them in charters -- and by those in state legislatures who then and now permitted them -- as safeguards necessary to maximize the prosperity of enterprises.

The emotional dedication that many have to the one share/one vote form of corporate decisionmaking stems I think in large measure from political rather than economic considerations. In the political life of this country, characterized as it is by a strong egalitarianism, no one quibbles with the idea that no one should have more than one vote, regardless of his prestige, his wealth, his position or anything else. That is unquestionably a desirable precept in a democratic society. But a corporation is not a political society. It is an economic entity with different purposes and different ends than the political state. As a matter of fact, if one wished to truly analogize the corporation to the political state, a better precept would be one vote/_one shareholder_, since that would most closely parallel the egalitarianism that is characteristic of our political society.

Many companies today have submitted to their shareholders proposals which in one way or another will or may result in an inequality of voting rights among shareholders as a means of thwarting attempts to take over the corporation and reshape it in accordance with the whim of someone whose only talent is often his access to junk bonds and other fanciful financing means. Of course, those who wish to be free to engage in these antics that pose such tremendous dangers to the welfare of the nation are hostile to these measures, and while they chant about the "rights of shareholders," they would deny shareholders the important right to determine how the voting rights in their corporation are to be distributed. These critics are not concerned with the rights of shareholders; they are concerned solely with their own right to move into a corporation and tear it up without regard to long range plans, job security, community welfare, terminated careers or the most efficient use of capital. The very fact that shareholders in a large number of corporations have voted in favor of measures to impede takeovers, including changes that redistribute voting power, suggest that they have a deep concern with the long-range welfare of the corporation and are not blinded by the possibility of quick profits at the expense of every other value incarnate in corporations. If the management and the shareholders of a corporation determine that the interests of the corporation will be best served by a voting structure that will discourage a hostile and forcible grab of control by some opportunist, in my estimation no one should thwart that right -- neither an exchange, the SEC, Congress nor anyone else. It is sheer pettifoggery to weep for the shareholder whose voting rights may be disproportionate to his equity and at the same time try to wrest from that shareholder the right to determine how voting rights should be distributed in his corporation.

Listening to the proponents of the drastic change in the law entailed in mandating one share/one vote for virtually all significant publicly held companies one would imagine that management was forcibly and unilaterally depriving shareholders of their vote. Nothing could be further from the truth. No publicly held company in this country has ever changed the relationship between voting rights and equity without the approval of a statutorily required majority of shares -- and the majorities have usually been substantial. One may wonder why shareholders have been willing, in virtually every instance in which the proposition has been put to them, to vote for measures that will or may reduce their voting rights. It certainly is not because of ignorance: the SEC requires the most fulsome disclosure in proxy statements soliciting votes on such issues of all the adverse consequences that may follow from approval of the proposal -- lessened likelihood of takeover premiums, reduced opportunity to participate in corporate decisionmaking, and on and on.

The reason shareholders approve these measures is clearly seen in surveys which show that individual shareholders do not have the high opinion of hostile tender offers that proponents of one share/one vote would have us believe. In a survey by Louis Harris and Associates last year, 60% of the individual shareholders surveyed thought hostile takeovers did more harm than good, a larger percentage, significantly, than the public at large and employees. A more recent survey by Penn + Schoen Associates found that among those surveyed who owned stock 77% were of the opinion that takeovers should be harder and less frequent and 68% of them thought that states should continue to pass laws making takeovers more difficult.

The simple fact is that individual shareholders, who are commonly regarded as a more stable investing group than institutions since they tend to hold their investments longer, don't think as highly of tender offers as do those who inflict them or the institutional investors who, for fiduciary and competitive reasons, are anxious for a quick windfall profit on their investment.

It is interesting that this effort to turn upside down two hundred years of history comes a matter of months after the Supreme Court in strong words reaffirmed the merit of that history. In CTS v. Dynamics Corporation of America decided in April of last year, the Court said

> No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders. (Emphasis added).

The Court remarked that "...state regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law..." and that "...it...is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares."

Proposals for the classification of common stock are often characterized as efforts of managements to "entrench" themselves. That is a calumny of American management that is too often, and too irresponsibly, repeated today, and unhappily by many who should know better. These proposals are most often originated by managements that are sensitive to the values that have become embedded in a corporation as a consequence of the labors, often of many generations, of management and other employees, enlightened long range planning, difficult struggles with the vast multitude of problems that confront management, particularly today when technology and the shrinking of distance and time magnify every challenge management confronts. The manager who struggles to maintain the integrity of his company in the face of proposals that will distort its capital structure, trash carefully laid diversification plans, compel sharp cutbacks in research and development expenses, undermine unnecessarily the hard earned security of employees, and sap the vitality of countless communities is not "entrenching" himself. He is protecting values that have been a long time growing in this nation, and for this he should not be faulted: he should be admired, for he is doing exactly what he was hired to do.

In closing I would urge that Congress listen to the voices of history rather than the clamor of opportunists; that it recognize the total absence of any evidence that the ability of corporate shareholders to shape the division of voting power among themselves in whatever fashion they wish has harmed either them or the community; that, like the Supreme Court, it recognize that state regulation of the corporate entities they create -- including, as the Court said, "the authority to define the voting rights of shareholders" -- is a firmly established principle of corporation law and practice, one that has served the nation well for two centuries. I urge that this Committee and the

Congress recognize who it is that is urging change. It is not the shareholders who invest in America's corporations, not to make a fast buck, but to realize gain over time as a result of the felicitous combination of their capital, management's skills, and certainly not least, the hard work of the corporation's employees. Rather those urging this revolutionary change in American law and American constitutional tradition are those who hope to gain control of corporations and then brutally refashion them to realize the maximum immediate gain for themselves without concern for the future welfare of employees, communities, suppliers and customers.

Mr. Chairman, members of the Committee, I urge that you transpose Mrs. Reagan's advice to this arena and simply say "no" to those people.

Thank you.

enfranchisement—which leads me to my next issue, which is really what are the issues and what shall we do about them?

That has become perfectly clear in the dialog before the SEC and it's been amplified this morning by the comments of many of the witnesses. The slogans of "management entrenchment" or "divorcing ownership from control" or "undermining accountability to stockholders" don't warrant the imposition of a blanket one share/one vote rule on capital structure. Rather, they invite much more careful scrutiny to determine how to deal with these subjects.

"Management entrenchment"—you look at that under the tender offer rules or going private rules, depending on how you understand the term. And on "disenfranchisement of stockholders"—you look at it under the proxy rules. We've been urging this on the Commission. We hope they will persist in their efforts.

Thank you.

[The complete prepared statement of Richard H. Troy follows:]

STATEMENT BEFORE THE

UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ON BEHALF OF THE

SECURITIES LAW COMMITTEE

OF THE

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

PRESENTED BY

RICHARD H. TROY
CHAIRMAN, SECURITIES LAW COMMITTEE
AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

RE: HEARING ON WHETHER LEGISLATION SHOULD BE ADOPTED THAT WOULD PROHIBIT AN ISSUER FROM BEING LISTED ON A NATIONAL SECURITIES EXCHANGE UNLESS EACH SHARE OF ITS COMMON STOCK INCLUDES THE RIGHT TO CAST ONE VOTE

ROOM 538
DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, D.C.
MARCH 17, 1988

Mr. Chairman, and members of the Committee, my name is Richard H. Troy and I am appearing in my capacity as Chairman of the Securities Law Committee of the American Society of Corporate Secretaries.

The Society is a professional association of business executives whose 3,000 members, representing over 2,400 corporations in the United States and Canada, are regularly involved in such matters as corporate governance, the regulation and trading of securities, proxy solicitation and other shareholder activities.

The Question

The Society is pleased to provide testimony with respect to whether legislation should be adopted that would prohibit an issuer from being listed on a national securities exchange unless each share of its common stock includes the right to cast one vote. The Society has taken an active role in the continuing dialogue on the issue of disparate voting rights, including participation at the two hearings conducted on the subject by the Securities and Exchange Commission.

Answer, in Brief Outline

In brief outline, our response to the question presented at today's hearing is as follows:

I. Legislation should not require corporate issuers uniformly to allocate one vote per share of common stock as a condition to listing on a national securities exchange because such a requirement:

   A. would unnecessarily prohibit legitimate and useful corporate structures and transactions, as illustrated by:

      1. existing corporate case histories;

      2. commonplace corporate structures and practices;

      3. useful business alternatives; and

      4. transactions which a reviewing court would uphold as a prudent exercise of fiduciary duty;

   B. would create unnecessary conflict with state law by imposing federal corporate law;

   C. would destroy the current balance of federalism and our understanding of the American corporation;

   D. would prevent boards of directors from taking those actions which their fiduciary obligations under state law may counsel them to take in order to protect stockholders;

   E. would exacerbate the current burden on the federal courts;

F. would tend to displace the courts, and thereby their effectiveness, in fashioning specific redress of specific abuses;

G. would ursurp the rights of stockholders to determine capital structure and other important matters;

H. would dliminate the investment alternatives represented by varied capital structure;

I. would constitute unprecedented federal merit regulation of securities;

J. would produce unduly enhanced antitakeover protection - the "doomsday machine" of all antitakeover devices; and

K. is not predicated upon identified need.

II. The real issue to be examined is not one vote per share of common stock but protection of stockholders against possible disenfranchisement.

A. Issues of stockholder disenfranchisement, management entrenchment and management accountability should be carefully and specifically addressed through review of the following regulations under the Securities Exchange Act of 1934:

1. the tender offer rules;
2. the going private rules;
3. the rules under §16;
4. the rules under §14; and
5. the rules under §10.

B. Legislation should not treat stockholders as "nitwits" by prohibiting them from considering and voting on matters of capital structure. (cf. Basic et al. v. Levinson et al., decided by the United States Supreme Court on March 7, 1988.)

III. Whatever market regulation rules on capital structure are established from time to time by the securities markets and approved by the Securities and Exchange Commission should be careful to permit varied capital structures, including disparate voting rights, in many situations.

A. Whatever its form, by rule or practice, market regulation should permit disparate voting rights in at least the following cases:

1. companies so structured at the time they first become publicly owned;

2. structures addressing the family interests of a family business;

3. structures addressing the needs of a specific business mission;

4. structures designed to preserve such values as reputation or quality;

5. structures designed to effectuate charitable purposes;

6. venture capital companies;

7. unseasoned or growth companies with special needs;

8. existing situations;

9. securities offered preemptively to existing securities holders;

10. transactions and structures wherein lesser voting rights are offered to new, as opposed to existing, investors;

11. acquisitions, divestitures and special purpose financings where the securities relate to the underlying transaction;

12. issuances and transactions authorized by boards of directors in the exercise of their fiduciary duties to protect stockholders (particularly in takeover situations); and

13. issues approved by independent directors and by public stockholders.

IV. The "stockholder responsibility gap" must be properly appreciated and not made the occasion for unwise legislation.

* * *

INTRODUCTION

I am sometimes asked: "What is wrong with one share/one vote?" The answer, of course, is that there is nothing wrong with one share/one vote. One share/one vote represents the predominant voluntary corporate practice today. But there are many serious reasons why this voluntary corporate practice should not be converted into a rigid rule of law limiting all capital structures.

Throughout the dialogue over the past two years on disparate voting rights, the Society has constantly been supportive of the predominant voluntary corporate practice - not mandated by law - that each share of common stock have one vote. More importantly, the Society has been supportive of the two important values associated with this practice: understandability (does the security holder understand what he has?) and fairness (is the security holder being cheated?).

Neither of these important values - understandability and fairness - would be guaranteed by imposition of a mechanistic one share/one vote rule. Nor, on the other hand, has the absence of a one share/one vote rule meant the loss of these values.

Preservation of these values has been due to predominantly responsible corporate action, on the one hand, and to vigorous and corrective response of the federal and state judiciary, on the other hand (a subject I will discuss in a few minutes).

The question, then, is not "what is wrong with one share/one vote?" but, rather, "what is wrong with varying from one share/one vote to attain desirable objectives?"

What is wrong with what General Motors Corporation did in issuing Class E and Class H common stock to effect acquisitions of large companies? What is wrong with what the Hershey Trust did in taking Hershey Foods Corporation public but retaining control in order to assure that the objectives of the trust would be achieved?

Again, the answer is that there is nothing wrong with what General Motors and the Hershey Trust have done nor anything wrong with other variations from one share/one vote which meet the needs of stockholders and the corporations they own. Unfortunately, however, meaningful distinctions have become somewhat obscured amidst the opportunistic rhetoric which has developed in the course of the current debate.

The slogan "one share/one vote" appears to have become the rallying cry for simplistic treatment of the complex relationships among stockholders and the corporations which they own. In fact, it does little or nothing to address the needs of stockholders, many of which needs can only be addressed through vigilant acts of boards of directors in discharge of their fiduciary duties.

In support of "one share/one vote" have been marshalled arguments on the subjects of management accountability, management entrenchment and shareholder disenfranchisement. In fact, each of these areas deserves far more specific scrutiny and, as I will discuss later, neither justifies nor would be significantly benefited by a simplistic "one share/one vote" response.

Takeover concerns - pro and con - also appear to have distorted the current dialogue. Deal makers and certain types of investors would subordinate all other considerations to the enhancement of the velocity and simplicity of deals. Also heard are voices of those who would ostensibly support "one share/one vote" as a protection for stockholders while, in fact, seeking to thereby deprive boards of directors of otherwise available alternatives which would provide them with the negotiating leverage to protect stockholders.

The true need is not to mandate a simplicity of corporate structure but to focus in a meaningful way upon the specific situations which the dialogue thus far has served to identify as sources of potential abuse. This I should like to do during the second portion of my presentation. In the first portion of my presentation, I should like to focus upon why legislation mandating a simplistic capital structure as a condition to listing on a national security exchange would be seriously inappropriate.

I. Legislation Should not Require Corporate Issuers Uniformly to Allocate One Vote Per Share of Common Stock as a Condition to Listing on a National Securities Exchange.

A. Prohibition of Legitimate and Useful Business Transactions.

A simple, direct and unavoidable result of a mandatory uniform rule requiring one vote per share of common stock as a condition to listing on a national stock exchange would be to outlaw or bring into serious question a wide variety of customary, legitimate and useful business forms and practices - without any need to do so. I should like to illustrate this under four categories: actual corporate case histories; commonplace corporate structures and practices; useful business alternatives; and special situations wherein the actions of boards of directors would be upheld by a reviewing court as a prudent exercise of fiduciary duty.

1. Corporate Case Histories.

As has been much publicized and discussed, General Motors Corporation has found it useful and appropriate to issue special classes of common stock in connection with two large acquisitions. Each of the two separate classes of common stock bears differing voting rights and differing dividend rights, each calibrated to the characteristics of the business being acquired and fairness in treatment between (a) the then current stockholders of General Motors (who approved the transaction) and (b) the former stockholders of the acquired companies who received the new classes of General Motors common stock.

In the case of Hershey Foods Corporation, a charitable trust set up by the founder continued to own 50.1% of the common stock of the corporation since first causing shares to be sold to the public in 1927. Retention of control was considered essential in order to further the purposes of the trust of which the sole beneficiary is the Milton Hershey School for disadvantaged children. In 1984, in an effort to raise needed capital for the corporation without diluting the control needed by the trust, the corporation moved to dual classes of common stock with disparate voting rights, through a charter amendment approved by the minority stockholders. The trust had advised the minority stockholders that it would vote in favor of the change only if a majority of the minority voted for the change. When 63% of the minority (79% of those voting) voted in favor, the trust also voted in favor and the dual class capitalization proposal was approved.

The board of directors of BDM International Inc. felt that the success of that company was due in large part to the scientific leadership and management skills provided by certain technology-oriented principal shareholders and that this leadership should be continued through disproportionate voting rights for the period of time during which their contribution could be expected to continue. This purpose was made clear in the proxy materials mailed to BDM stockholders:

> "Because the Class A common stock is being proposed only for the limited purpose of continuing the voting control of the principal shareholders during the time the principal shareholders can be expected to contribute significantly to the management direction of the company, the proposed amendment provides that on January 1, 1998, the voting and dividend rights of the Class A and Class B common stock will become equal...."

Dow Jones & Company, Inc. created a new class of common stock in order to insure the journalistic independence and integrity of The Wall Street Journal and the company's other publications and services. The company has pointed out that it would be particularly unfair to the company's minority stockholders, who voted three to one in favor of the change, to have the company's stock delisted.

For similar reasons of journalistic independence, the Times Mirror Corporation adopted dual class capitalization to insure the continued control by certain family descendants of the founder, Harrison Gray Otis. The Washington Post Company, New York Times Company and numerous other newspapers around the country have also chosen to bolster their journalistic independence in similar fashion.

The Potlatch Corporation of California adopted time-phased voting in 1985, with all stockholders receiving four votes per share as of the effective date. New purchasers would have only one vote per share until they held the shares for four years, at which time they would have four votes per share. Potlatch common stock rose over 50% in market price during the following year, outperforming all but one of its major forest products competitors. The decision of the corporation and its stockholders to adopt time-phased voting was grounded in the long-term focus of the business of developing forests, with forest growth measured in decades and capital projects taking up to five years.

Stockholders of the J. M. Smucker Company who hold Smucker stock for four years have their shares automatically converted into shares bearing ten votes per share. All stockholders of the company were accorded such long-term status as of the effective date of their charter change. The company was founded by, and continues to operate under the direction of, Smucker family members. The Smucker name is considered to represent a substantial corporate asset equivalent to a statement of quality, consistency and stability in Smucker products. The Smucker family believes that shareholder adoption of the time-phased voting structure of Smucker has enabled the company to live up to its commitment to quality in the products associated with the Smucker business and family name.

Americus Shareowner Service Corp. has created unit investment trusts - the so called Americus Trusts - which, in effect, exchange shares of common stock in major corporate issuers for investment units which so divide the equity interest that one unit (PRIME) bears the voting right and the other unit (SCORE) does not. Americus Trusts have been established with respect to the common stock of thirty major corporate issuers. These trusts have gained a certain degree of acceptance in the market as alternative investment vehicles but presumably would be banned under a uniform one share/one vote market regulation rule.

The files of the Securities and Exchange Commission contain numerous additional examples of corporate case histories illustrating the purposes served through varying capital structures, as well as statements by corporate issuers who do not have such structures but firmly believe that their flexibility to do so should be preserved. I should like at a later date to supplement this present statement with an appendix containing more detailed information in this regard.

2. Commonplace Corporate Structures and Practices.

Quite apart from the case histories of individual corporations, there are a number of time-honored useful corporate practices and structures which would be called into question, if not outright prohibited, by a federal rule rigidly mandating one share/one vote. The fact that the rule might not clearly proscribe a particular practice, but only leave it in doubt, would be small consolation. A federal court, faced with the difficult question of interpreting a new federal rule in a vacuum of federal policy and precedent, would be torn between extending the rule to cover the practice or taking a literal view that the practice is "not covered."

For example, the statutes of a number of states, and the charters of corporations incorporated therein, provide for cumulative voting whereby the one vote per share of stock which might be cast as one vote for each of the director nominees standing for election might be cast instead as a multiplicity of votes for one nominee and no votes for the other nominees. The purpose of cumulative voting, of course, is to enhance the ability of minority stockholders to elect at least one director even though they might not have enough votes to elect an entire slate. Under a federal one share/one vote rule, however, this practice would be called into serious question, if not outlawed, as a practice representing multiple votes per share.

Under many state statutes and/or corporate charters, a super-majority vote - perhaps two-thirds or three-quarters - is required for stockholder approval of such important matters as mergers, charter amendments or "fair price" in a takeover. Would a federally mandated one share/one vote rule prohibit such super-majority provisions on the ground that by requiring more than a simple democratic majority for action, the super-majority provision has effectively distorted the one share/one vote principal? Super-majority provisions are designed to protect minority stockholders against fundamental change in their position. A federal court presented with the issue would have to decide whether the new federal rule was designed to facilitate corporate takeovers by majority vote or whether such an interpretation would produce the ironic and unintended effect of stripping minority stockholders of one of their few protections against fundamental change. Would the outcome depend upon who was doing the takeover? Or who was being benefited by the takeover? Or whether the otherwise protected minority approved or disapproved?

Even the commonly accepted practice of having staggered boards of directors could be called into question. In usual practice, a staggered board of directors is divided into three classes, with each class serving for three years with terms expiring one year apart. Under a mandatory one share/one vote rule, the question would be whether this customary staggered board structure is to be interpreted as reducing voting power to only one-third vote per share because only one third of the directors can be elected at any annual election. Does it depend upon whether the staggered board was a management proposal designed to perpetuate the present board of directors rather than a stockholder proposal seeking to stabilize the governance of the corporation? Similarly, if a proposal were made to repeal the staggered board provisions of a corporate charter, would this represent the alteration of voting rights in violation of the proposed uniform rule? Or, again, would it depend upon who sought the change and why? By what stars is a federal court to guide itself in such uncharted waters?

A recently accepted convention on the corporate landscape is the stockholder rights plan or poison pill. Under some plans, rights might be converted into securities with multiple votes; under other plans, rights might be converted into multiple securities with single votes but with the same mathematical effect. Would either be outlawed under the new rule? Would both be outlawed?

Preferred stock often carries voting rights, sometimes limited to default situations and sometimes not. Would existing shares of preferred stock be deemed to violate a federal one share/one vote rule if they had (a) significant voting power or (b) more voting power than the common stock or (c) voting power disproportionate to their equity representation in the capital structure? Would new issuances of preferred stock differ from existing preferred stock? Would the new federal rule be designed only to assure a simple mechanistic allocation of one vote per share of common stock - or to protect the totality of common stock voting power against the voting power of other classes of stock?

Some preferred stock is convertible into common stock. Such conversion into common stock may give the holder more votes or fewer votes than before the conversion. What policy considerations would dictate whether such a relationship is consonant with or contrary to a federally mandated one share/one vote rule?

Similarly, state law provides that voting rights may be given to bond holders and that such voting rights need not be limited to default situations. Also, debt may be convertible into common stock. How are voting rights attached to debt securities to be adjudged in connection with a one share/one vote rule?

The same question can be asked in respect of voting trust arrangements, standstill agreements, long-term proxies, businesses chosing partnership rather than corporate form and businesses subject to statutory or regulatory restrictions on ownership (e.g., communications, defense, shipping and banking).

My comments with respect to the foregoing are hardly meant to be exhaustive. They should, however, serve to illustrate the point that a federal rule mandating one vote per share of common stock as a condition for national market listing would either proscribe a number of perfectly acceptable corporate structures and practices or cast serious doubt upon their acceptability without providing the judicial system with any sound policy guidance from which to draw proper conclusions.

3. Useful Business Alternatives.

The proposed federal rule will clearly deprive corporations of certain capital raising alternatives which, in the absence of such a rule, would represent prudent management under the appropriate circumstances.

For example, the debt/equity ratio of a corporation may counsel it to raise additional capital without either adding additional debt, on the one hand, or diluting the equity voting power of its existing stockholders, on the other hand. The issuance of non-voting or low-voting common stock might well be appropriate to the circumstances but would be prohibited by the new federal rule.

Similarly, a corporation in somewhat precarious financial condition may need to induce new common stock investors by offering increased voting rights protection to new common stockholders on certain issues affecting the corporation. Of course, this would require a charter amendment with approval of the existing common stockholders. However, this could not be done at all if a federal one share/one vote rule were in effect.

Also, the tax laws - whether pertaining to individual taxation, corporate taxation or taxation of intracorporate dividends - may motivate corporations to make their securities more attractive by altering the mix of dividends and voting rights. Under a one share/one vote rule, this could not be done at all if the voting rights of common stock were affected.

Existing issuances of preferred stock, convertible preferred stock and convertible debt securities already create an indirect claim upon equity voting rights. Depending upon the interrelationships involved, the proposed new rule might well force either a conversion of the securities, a modification of their rights or a delisting of the issuing corporation.

In short, state laws have traditionally permitted experimentation and evolution in corporate law and structure, as if under controlled laboratory conditions. A rigid, uniform one share/one vote rule would have the unfortunate effect of banning any such further development which might stray beyond its procrustean bounds.

4. Transactions Which a Reviewing Court Would Uphold as a Prudent Exercise of Fiduciary Duty.

Boards of directors are called upon to exercise judgment and either recommend or take action in a variety of difficult situations. These include, by way of example, financial crisis of the corporation, insolvency, capital restructure and change of control. Often enough, their decisions are second-guessed by litigants before reviewing courts. And, often enough, the actions of directors are upheld by reviewing courts as actions which the directors not only were permitted to take but also should have taken under the circumstances.

The point here is simply that there should not be put into effect a legal rule mandating one share/one vote which would invalidate transactions which a reviewing court would uphold as a prudent exercise of fiduciary obligation.

B. Conflict with State Law.

Corporations are creatures of state law. Their capital structures are, in effect, the result of a tripartite agreement among the legislature, the corporation and the stockholders. As was noted last year by the United States Supreme Court in CTS Corp. v. Dynamics Corp. of America, 107 S.CT. 1637 (1987),

> "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting of rights of shareholders."

A legislative or regulatory requirement denying access to public markets to corporations not adhering strictly to one share/one vote would result in varying forms of conflict with substantive state law and the resulting contract with stockholders. In some cases, there would be direct preemption; in others there would be preemption in effect.

Corporations currently having disparate voting rights would be required to alter their capital structures or be delisted, a decision which lies not with the corporations but with their stockholders. The stockholders might well refuse to change their contract and would have every right under state law to persevere in this posture. Yet the proposed rule denying their shares access to public markets would, in effect, threaten them with economic sanction if they chose not to yield their state law rights.

Boards of directors of corporations are charged with fiduciary duties to protect the interests of stockholders. Under certain circumstances, this duty may require boards of directors to consider differing capital structures, including those having disparate voting rights. The proposed one share/one vote requirement would conflict with this duty by threatening the economic sanction of delisting.

In recent years, some states have adopted control share statutes which may apply to domestic corporations either automatically or through corporate election. A one share/one vote rule would directly preempt such statutes, including the Indiana statute (upheld by the Supreme Court in the CTS case) under which stockholders may vote to produce a single class of common stock with disparate voting rights.

[From the National Law Journal, July 6, 1987]

Is a "One Share, One Vote" Rule a Good Idea?

(By Richard H. Troy)

All the classic question about the nature, role and legitimacy of the publicly held American corporation are surfacing again in the continuing debate over whether "there oughta be a law" mandating one vote per share of common stock.

The outpouring of viewpoints reflects biases deeply woven into the social fabric of our nation. Advocates of every stripe have advanced concerns of an economic, political, social, legal and regulatory nature.

"Freedom," "protection" and "responsibility" are invoked by all comers, regardless of viewpoint. Circularity, "premise-begging" and self-interest run rampant.

The result of the present exercise will undoubtedly be pragmatic conpromise. To appreciate the nature of this compromise as well as the importance of the current episode, it is well to note first the background and then the focal points of the current debate.

In the 1920s, preceived abuses in the allocation of voting rights led the New York Stock Exchange (NYSE) to impose its "one share, one vote" rule whereby the exchange would, in effect, refuse to list a company if it had disparate voting rights within or among its class or classes of common stock or common-stock equivalents. Over time, only the Pacific Stock Exchange adopted a similar rule. The American Stock Exchange (AMEX) adopted a modified rule, and the National Association of Securities Dealers (NASD) none at all.

THE DIFFICULT DECISION

In the early 1980s, several corporations found themselves in situations in which it was appropriate to have dual classes of common stock with unequal voting rights. As long as the NYSE adhered to its rule, such companies had to choose between their preferred capital structures and listing on the NYSE. The NYSE, for its part, risked losing attractive securities to other exchanges. In 1984, the NYSE commenced extensive review of the matter and also imposed a moratorium on enforcement of its "one share, one vote" rule pending the outcome.

In 1986, after prolonged re-evaluation of its own position and after unsuccessful attempts tc interest other markets in adopting a "one share, one vote" rule, the NYSE made the difficult decision to modify its existing rule to permit listed companies to have common stock with unequal voting rights, provided that such issuances were approved by a majority of the issuer's independent directors and public shareholders. [1]

In its Sept. 16, 1986, letter to the Securities and Exchange Commission accompanying the filing seeking approval of the rule change, the NYSE articulated its continued support for the "one share, one vote" concept but noted that "only a change in federal, state or SEC requirements could promulgate the one share, one vote concept across all market centers." The letter concluded:

While the NYSE reaffirms its commitment to a one share, one vote policy, the Board's action attempts to deal with the realities of modern day corporate environment and still preserve the NYSE long-standing philosophy of providing investors with an essential measure of shareholder participation. It also reflects a recognition that the NYSE can neither dictate corporate governance standards for other self-regulatory organizations, nor unilaterally maintain such standards not required by other market centers in today's competitive environment.

Upon receipt of the NYSE application for approval, the SEC provided for a comment period and, given the breadth of the impending outpouring on the subject, scheduled two days of public hearings on Dec. 16 and 17, 1986. The Amex thereafter announced that it had voted to drop from its rules any restrictions on dual class issuances. [2] And the debate was on.

SETTING THE STAGE

It quickly became apparent that the request by the NYSE for approval of its rule change had simply set the stage for discussion of the larger issue. If "one share, one vote" were a value to be universally achieved, it would not be achieved simply by denying the NYSE its requested rule change while permitting other markets to continue with few or no rules at all. Such an approach would be not only futile in policy but also discriminatory and punitive in effect.

In short, a market listing requirement dictating corporate capital structure is a surrogate for federal corporate law directly conflicting with present state law governing the creation and governance of corporations, their relations with their stockholders and the fiduciary obligations of boards of directors.

C. Destruction of the Current Balance of Federalism; Destruction of our Understanding of the American Corporation.

It flows from the foregoing comments that the current balance of federalism would be deeply disturbed through a national market listing requirement which dictated the capital structure of corporations. No longer could one look to state legislatures, state agencies and the state and federal courts for secure guidance with respect to the affairs of corporations. Rather, the freedom of state law making authorities to shape and regulate the affairs of their corporate creatures would now be severely impacted by a federal agenda of uncertain dimensions.

Otherwise put, the American corporation can be understood today, with whatever degree of difficulty, through the body of state law which created it and which has been interpreted in a coherently evolving manner by state and federal courts. To superimpose a federal policy agenda upon the state-created corporation, whether through a rule of market regulation or otherwise, is to set up priorities and purposes at variance with what would otherwise exist under state law, seriously undermining our currently accepted understanding of the nature, purposes and governance of corporations. A most significant guidepost with respect to capital structure would be shifted to the federal arena where no clear policy has been charted, no interpretive expertise is available and no authoritative body is in a position to harmonize the conflicts - except through the efforts of courts which will have been provided precious little guidance.

Again, the words of the Supreme Court in CTS Corp. v. Dynamics Corp. of America are relevant:

> "It is an accepted part of the business landscape in this country for states to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares."

D. Interference with Directors' Fiduciary Obligations.

State law requires boards of directors to exercise their fiduciary responsibilities to protect the interests of stockholders. In the exercise of these fiduciary duties, it has become commonplace today that boards of directors must consider the issuance of a poison pill or a restructuring of the corporation in order to enhance the negotiating position of the board of directors to achieve a more favorable transaction for the stockholders in the face of a hostile takeover attempt. A federal rule prohibiting dual class voting would, however, either explicitly or implicitly prohibit or inhibit the board of directors from taking a variety of such actions, even though such actions would otherwise be upheld by a reviewing court as a prudent, if not also mandatory, response by the board of directors in an effort to protect the stockholders. It is difficult to imagine a policy consideration significant enough to justify a new federal rule which would have such a deleterious effect.

E. Clogging the Federal Courts.

The proposed rule of market regulation would be federal in nature. The possibilities of direct conflict with, or ambiguity with respect to, this rule have been briefly described in my foregoing remarks. The net effect of this is to introduce into normal state corporate law disputes the omnipresent possibility of a federal cause of action. As long this federal cause of action can be pleaded with any colorable support, it may be used by litigants to institute suit in, or remove state court cases to, the federal court system. Under the doctrine of pendant jurisdiction, basic state law controversies would be imported into the federal court system at the behest of whichever litigant sought to thereby gain a perceived advantage. As a corollary effect, there would be removed from the courts of each state a certain flow of corporate litigation which would otherwise serve to further develop the corporate law of that state through its courts in an orderly fashion.

F. Role of the Courts

State and federal courts have proven themselves more effective than any other medium of government in addressing and correcting abuses in the corporate area. Whereas some years ago one might have spoken of the role of state law and of the courts with somewhat less conviction than today, the decisions of state and federal courts applying state law over the past several years leave absolutely no doubt that boards of directors of publicly held corporations are currently under effective scrutiny as never before.

The poison pill, to the extent perceived to be an abuse, has ironically become its own antidote by inviting severe judicial scrutiny. The poison pill has invited the courts into the boardroom to examine both the motivation of its institution and the later, critical decision as to whether or not to redeem the pill. The result has been both heightened judicial scrutiny and a heightened level of care on the part of directors, once a pill has been triggered but is still subject to redemption by director action.

Similarly, the "lockup" in corporate takeovers is virtually a thing of the past. In a series of decisions, courts have invalidated the "lockup" technique as a device which, under given circumstances, may unfairly entrench management, favor one bidder to the detriment of another or fail to take proper regard of the interests of the stockholders. With alacrity, skill and telling effect, courts are directing boards of directors to protect the interests of stockholders, not the interests of management; to seek the highest price in auction situations and not to favor one bidder over another; and to be more active, rather than less active, in protecting stockholder rights - particularly as the directors may be the only effective means for protecting stockholders in takeover situations.

These court decisions are not isolated or irrelevant phenomena. They have been translated into the behavior of negotiators, lawyers and other corporate actors in doing deals. These court decisions have proven to be a dramatically effective means of modifying and regulating behavior.

The ironic effect of a new federal rule mandating capital structure would be to displace the effective intervention of the court systems by legislating out of bounds certain transactions which boards of directors would otherwise recommend or initiate in an effort to discharge their fiduciary obligations to their stockholders. This would deprive stockholders of certain protections which might be afforded them by their directors and, concomitantly therewith, would lessen judicial assistance to stockholders in areas where it has proven most helpful. Moreover, as discussed a few minutes ago, this would divert judicial energies into uncertain applications of a new federal rule whose policies are anything but clear.

G. Usurpation of Stockholder Rights.

A federally mandated one share/one vote rule would, of course, usurp stockholder rights to determine capital structure. It would also preclude stockholders from voting on matters which would involve an alteration of their current voting rights. It would preclude stockholders from purchasing common stock without voting rights or to exchange their present stock for stock with lesser voting rights or greater voting rights.

By thus preventing stockholders from voting on matters of voting rights or dealing with transactions affecting voting rights, the new federal rule would effectively treat stockholders as "nitwits", a practice which, as I shall discuss in a few minutes, the Supreme Court of the United States has recently criticized in another context.

H. Elimination of Investment Alternatives.

As indicated, there exist today many public companies with capital structures which do not fit a rigid one share/one vote model. In and of themselves they represent investment opportunities which differ from, and are alternatives to, the predominance of companies with simpler capital structures. Some of these companies may even be said to constitute a separate market wherein change of control is not a significant element. A procrustean prohibition in the form of a rigid one share/one vote rule would deprive the marketplace of these investment alternatives.

I. Federal Merit Regulation of Securities.

Another obvious effect of a federal one share/one vote rule would be to embark for the first time upon federal merit regulation of securities. As the Supreme Court has again reminded us as recently as ten days ago, the fundamental purpose of the federal securities laws is to implement a "philosophy of full disclosure," not to embark upon substantive or merit regulation of securities. Basic Inc. et al. v. Levinson et al. (decided March 7, 1988). A federal market regulation rule requiring one vote per share of common stock would fly in the face of this long standing federal posture by denying national market access to classes of securities according to the content of their voting rights rather than according to the adequacy of disclosure with respect thereto.

J. Enhanced Antitakeover Protection - the "Doomsday Machine" of Antitakeover Devices.

A federal market regulation rule mandating one share/one vote would unwittingly create what is perhaps the most effective antitakeover device yet devised. The "doomsday" scenario would be as follows:

If all markets were subject to a rigid one share/one vote rule, any target corporation could decide to issue an offending security, thereby making illegal under the rule any further transaction in its common stock using any means subject to federal market regulation. This would produce either an end to the trading in its stock - or chaos - or at least a suspension in trading until further defenses could be devised.

While it may not be likely that a board of directors would invoke the "doomsday" scenario in order to halt trading in its stock while it sought effective means to protect its stockholders, the matter cannot be prejudged. The particular circumstances of an unfair offer might justify or even urge a period of halt or of chaos in order to permit a corporation to find a better deal for its stockholders.

The "doomsday" scenario is not a matter of whimsy. It is extraordinarily difficult to fashion a one share/one vote rule so as to preclude invocation of the "doomsday" scenario. The only suggestion which has been made to date appears to be to leave certain markets unaffected by the one share/one vote rule, thereby permitting an escape valve for trading. However, if alternative markets are adequate as an escape valve, they are also adequate as a subterfuge to escape the rule entirely.

Although the "doomsday" scenario has been discussed for well over a year now, no effective antidote has been proposed.

K. Lack of Need.

One of the most transparent and painful deficiencies in the idea of imposing a federal one share/one vote rule upon all markets is the lack of need for such a rule.

As I have intimated in some of my earlier comments, and as I will discuss in detail in the next few minutes, the protracted dialogue on the subject of one share/one vote has, if anything, served to winnow away much of the rhetorical chaff so that one can begin to see the contours of the real issues upon which attention should be focused. These issues have nothing to do with the mechanistic allocation of one vote per share of common stock but, rather, with the question of whether certain types of circumstances present the opportunity for specific abuses of stockholder rights, so that remedies appropriate to these specific abuses might be considered. This has been quite evident in the evolution of the dialogue from the generalized "one share/one vote" discussion of the latter part of 1986 to the more productive and specific discussion of stockholder disenfranchisement in the summer of 1987.

In the next few minutes I should like to turn our attention to what seems to be the real issue emerging from the protracted one share/one vote debate.

II. The Real Issue to be Examined is not One Vote Per Share of Common Stock but, Rather, Protection of Stockholders Against Disenfranchisement

A. What is Required is Particular Examination of Specific Possible Abuses, not Broad Rule Making.

The current proceedings before the Securities and Exchange Commission have continued to serve as a most useful distillation process. They commenced in the latter part of 1986 when the New York Stock Exchange, after some years of study, proposed to vary its decades-old one share one/vote practice with a rule change which would permit exceptions for certain situations, including securities issuances approved by independent directors and public stockholders.

The SEC scheduled two days of hearings in December, 1986 on the proposed New York Stock Exchange rule change. The hearings and attendant proceedings evoked a generalized and unfocused outpouring of viewpoints under the broad heading of one share/one vote. It was suggested that the SEC should not only refuse to approve the rule change proposed by the New York Stock Exchange but also should develop its own one share/one vote rule and impose it uniformly upon all marketplaces.

Upon examination, however, it quickly became apparent that the cries of "management entrenchment," "divorcing ownership from control," and "undermining accountability to owners" did not warrant imposition of a rule rigidly prescribing capital structure. Rather, they simply invited more careful scrutiny to determine whether any more precise rule change might be in order.[1]

Accordingly, after some distillation of the views theretofore presented, the SEC commenced its own rulemaking proceedings with the somewhat more specific focus of stockholder disenfranchisement. While in form proposing a regulation which would require self-regulatory agencies to adopt rules on the subject of voting rights, the thrust of the SEC proposal was to seek to restrain only those practices which would operate to disenfranchise stockholders. While the SEC proposal - proposed Rule 19c-4 - is not without its very real problems, it is to be hoped that the comments received in response thereto will enable the Commission to further refine its efforts to deal in a meaningful fashion with those discreet elements of potential abuse which the debate has served to identify.

For example, academicians have spoken of the possibility of "management entrenchment" if disparate voting rights were to proliferate. Upon examination, however, it would appear that if "management entrenchment" suggests a seizure of control or ownership by insiders,—then the proper response should be review of the Commission's present "going private" rules, as well as the rules under Section 16 of the '34 Act, not a rule banning all disparate voting rights.

Similarly, if "management entrenchment" suggests that management takeovers or insider takeovers are being favored over third party takeovers, then this, in turn, should invite scrutiny of the Commission's tender offer rules under the Williams Act, rather than a prohibition of any capital structures which may vary from a rigid one share/one vote formula.

There has also been considerable comment on the dynamics of the proxy voting process and upon the "collective action" aspect of marshalling stockholder votes. In the course of this dialogue have surfaced such questions as whether cumulative voting, weighted voting and super-majority provisions which are designed to protect minority stockholders should be done away with in the name of one share/one vote, thus replacing the "tyranny of the minority" with the votes of the majority. These and other considerations argue for careful examination of the proxy rules under Section 14 of the '34 Act to determine whether, in effect, stockholders are being disenfranchised.

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[1] In the interests of time, rather than summarizing all of the viewpoints which emerged in the time frame December 1986-June 1987, I am enclosing as an exhibit to this statement a copy of an article from the National Law Journal edition of July 6, 1987.

Finally, the dialogue has served to suggest that stockholder disenfranchisement is deserving of examination under the antifraud and antimanipulation rules of the Commission under Section 10 of the '34 Act.

B. Legislation Should Not Treat Stockholders as "Nitwits".

As we were reminded just ten days ago by the Supreme Court in Basic Inc. et al. v. Levinson et al., the purposes of the federal securities laws are not to regulate the substance of securities but, rather, to protect stockholders through requiring adequate disclosure and proscribing manipulative or deceptive practices. The Supreme Court in that case specifically rejected the proposition that target companies need not inform their stockholders of preliminary merger negotiations for fear that they might mislead them or foster false optimism. The Supreme Court rejected this rationale, stating that

> " 'It assumes that investors are nitwits, unable to appreciate - even when told - that mergers are risky propositions up until the closing.' Flamm v. Eberstadt, 814 F2d, at 1175. Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress."

In the present debate, proponents of one share/one vote have argued that stockholders should be protected by preventing them from ever voting on propositions which would approve or disapprove the issuance of securities with greater voting rights or lesser voting rights, and should be protected from any opportunity to exchange, whether in a merger or otherwise, their present securities for other securities bearing a different allocation of voting rights.

In short, proponents of a rule mandating one share/one vote are stating that stockholders cannot be trusted to know their own best interests and therefore should not be permitted to vote on matters affecting voting rights. Not only does this infringe the rights of stockholders, as I have discussed a few minutes ago, but, in the vocabulary of the Supreme Court, it treats stockholders as "nitwits" who are incapable of forming an opinion or drawing a conclusion on a basic investment or business decision.

III. Market Regulation Rules on Capital Structure Established by the Self-Regulatory Organizations and Approved by the Securities and Exchange Commission Should be Careful to Permit Varied Capital Structures, Including Disparate Voting Rights, in at Least the Following Situations.

A. Some self-regulatory organizations may elect to adopt rules on voting rights or capital structure with a sufficiency of exceptions to accommodate the legitimate interests of stockholders and the corporations they own. Other self-regulatory organizations may choose to proscribe only those certain types of arrangements whose purpose and effect are to unfairly impact the voting rights of stockholders.

Whichever form regulation, if any, may take, it is important to focus upon those types of structures and transactions which, in any event, must be preserved.

The dialogue thus far has served to highlight a variety of situations which may directly or indirectly involve disparate voting rights and must continue to be permitted under any regulatory scheme affecting either issuers or the public markets in which their securities are traded. These include the following:

1. Companies structured with disparate voting rights at the time they first become publicly owned. As the debate on one share one vote has matured, there is growing recognition that there is no sound policy argument for suggesting that stockholder disenfranchisement would occur where the structure of the securities and their voting rights are already defined before the decision to purchase. The Supreme Court's recent disparagement of the paternalistic, "nitwit" treatment of stockholders only serves to emphasize this.

2. Family companies with a strong interest in continued family control. Certain corporations have sprung from family origins and continue to prosper from continued family control. Family ties are not only disclosed but are presumably viewed as a positive attribute from the standpoint of the potential investor.

3. Corporations with control structures directed to specific business needs. For example, as I discussed earlier, BDM International, Inc. viewed its success as largely dependent upon the control and direction exercised by persons with certain technology expertise and, for this reason, provided for such control to continue for a limited period of time to end in the year 1998.

4. Where such matters as reputation or quality may be at stake. As discussed above, this was a matter of great concern to members of the Smucker family in controlling the corporation bearing their name, the J. M. Smucker Company.

5. Charitable Purposes. Hershey Foods Corporation is an example wherein the charitable trust which had received all of the corporation's stock from its founder felt that it could not achieve the charitable purposes of the original deed of trust unless, when it sold some of the corporation's stock to the public, it retained control over the corporation.

6. Venture Capital Companies. It is common practice not to risk venture capital unless there is put in place a sufficient control mechanism which will enhance the prospects of the venture. Given the variations in capital structure and in public and private ownership, this may involve disparate voting rights of common stock to insure control directed at the objectives of the venture.

7. Unseasoned or Growth Companies with Special Needs. This category of companies may include a number of the foregoing situations (venture capital, family businesses, businesses with specific missions) or simply companies which are sufficently new as to require special control arrangements to insure their success.

8. Existing Situations. As is evident in the record of the proceedings before the SEC and elsewhere, there currently exist a number of publicly held companies with capital structures involving disparate voting rights. No policy would be served by penalising the investors in these companies through delisting or through forced restructure.

9. Securities Offered Preemptively to Existing Security Holders.

   The fear has been expressed that new issuances of securities with high voting rights might disadvantage present security holders. This concern would not apply, however, if such securities were offered preemptively to existing stockholders.

10. Offerings with Lesser Voting Rights to New Investors. As a corollary to a number of the comments I have made previously, it seems clear that no stockholder disenfranchisement occurs where new securities with lesser voting rights are issued to new investors, whether or not prior investors also choose such securities.

11. Acquisitions, Divestitures and Special Purpose Financings. As is well known to the investing public, General Motors has issued two special classes of common stock to the former stockholders of companies acquired by General Motors. These two special classes of common stock bear dividend rights and voting rights which are calibrated to the acquired business and to the relationship between those acquired businesses and the other businesses of General Motors. There is no suggestion of disenfranchisement or

unfairness in arrangements of this type. On the contrary, the specific virtue of this type of securities issuance is that it permits an acquiring corporation to make more appropriate allocations between its existing and new stockholders.

12. Exercise of Fiduciary Duties by Boards of Directors. As I have discussed earlier, boards of directors are charged under state law to exercise their fiduciary duties to protect stockholders in a wide variety of difficult situations, including situations involving unsolicited takeover overtures. Such boards of directors are not only permitted, but may be well advised, in the exercise of their fiduciary obligations to consider the issuance of a poison pill or the restructuring of the corporation, either one of which might, depending upon the circumstances, involve an effect upon voting rights.

13. Approval by Independent Directors and Public Stockholders. The rule change proposed by the New York Stock Exchange would permit issuances of securities which are approved by both the corporation's independent directors and its public stockholders. The dialogue to date suggests that under such circumstances there would be neither stockholder disenfranchisement nor substantial unfairness. This also seems consistent with the Supreme Court's recently articulated view that stockholders not be treated paternalistically as being incapable of understanding and deciding.

IV. The "Stockholder Responsibility Gap" Must be Properly Appreciated and Not Made the Occasion for Unwise Legislation.

Much of what has been aired in the course of the one share/one vote debate is nothing more than a further by-product of the "responsibility gap" - more properly, the "stockholder responsibility gap" - which we have built into our system. Under our legal and economic system we prize both the limited liability of stockholders and the liquidity of secondary markets for equity securities.

This produces the now recognized "responsibility gap" wherein all of us as stockholders are free to buy and sell all of corporate America without one whit of responsibility for the effect of our actions upon the corporation itself, its products and services, its employees, its customers or even our co-stockholders.

In the tender offer area, no one asks the stockholder to fill the "responsibility gap." Rather, the target company places responsibility upon the raider; and the raider replaces responsibility upon the target. Both, in turn, wish this responsibility off upon legislatures, regulatory agencies and the courts to assist them with rules and adjudications. The important thing here is not to lament or necessarily eliminate the "responsibility gap" but to recognize that the different types of problems which flow from it may require different types of solution.

For example, just because the "responsibility gap" exists in order to benefit stockholders through limited liability and liquid securities markets, does not mean that all solutions need be in the direction of enhancing such limited liability or enhancing the speed and facility of transactions. Presumably, one must also consider the rest of society and not simply stockholders - majority or minority - or market prices. Presumably, one does not resolve the "responsibility gap" in all cases at the expense of industrial productivity, continued employment, minority stock interests, or the interests of customers, communities or the national welfare.

A corporation exists in order to engage in transactions which are intended to benefit customers and profit stockholders. When a corporation chooses to have its securities traded in the public marketplace, it assumes certain added responsibilities in that connection. These added responsibilities, however, are not intended to subordinate the purposes of the corporation to the trading interests of the marketplace or the desires of deal makers for velocity and ease.

The "one share/one vote" slogan has too often been raised by those who would seek only a marketplace advantage. Large institutional investors, who could scarcely be described by any court as "nitwits," argue for one share/one vote to facilitate their market transactions, and argue against disparate voting rights which might enhance the ability of target company directors to slow the speed of transactions and negotiate a better deal for all of the stockholders. Similarly, at least one "shareholder" organization has been formed to ostensibly champion stockholders' interests in achieving one share/one vote, whereas the practical effect of achieving this goal would be to facilitate the plans of corporate raiders who would prefer to encounter target company boards of directors less able to fend for all of their stockholders.

Accordingly, and as a matter of perspective, in the context of the debate over one share/one vote, just as we would find it inappropriate to resolve "responsibility gap" issues in favor of management entrenchment or inside dealing, so also we would find it highly inappropriate to resolve these issues in favor of the highest market price of the moment, the lightening speed of the "deal" or the interest of the large and powerful stockholder

Instead, in keeping with the time honored common law, skeptical tradition of lawmaking in this country, we would expect, in the course of framing remedial action, a process whereby specific need is first identified and isolated and a specific remedy is then tailored to meet that need without needlessly imbalancing other interests or becoming captive to the rhetoric of the day.

Mr. Chairman and members of the Committee, we thank you for this opportunity to present our views.

The larger issue, as recognized in the SEC's request for comments, included whether "a uniform one share, one vote policy [should] . . . be applied across all securities markets," and, if so, whether "certain types of companies or situations uniformly [should] . . . be exempted from such a policy. [3]

Participants in the public hearings of Dec. 16-17 appeared on seven panels, consisting of representatives of the exchanges, the academic community, shareholder interest groups, institutional investors, public companies, state securities regulators and individual shareholders. Attention focused primarily on the larger questions—i.e., whether there should there be a mandatory "one share, one vote" rule applicable to all marketplaces—and only secondarily on the NYSE rule change that had precipitated the debate.

A clear majority of speakers and words spoken favored disapproval of the NYSE rule change together with imposition of some form of a "one share, one vote" rule upon all exchanges and market places. This majority of spokespersons articulated their investement preferences as to how corporations should be structured, how corporations should be governed and how the control of corporations should pass.

Had a plurality of panelists consisted of corporate representatives, corporate managers, corporate employees, and investors with strong investment commitments to particular corporations, presumably the weight of comment would have been in the opposite direction. Small wonder, as viewpoints tend to differ according to whose lives and properties are being affected.

IN FAVOR OF A RULE

The focal points of the debate were overlapping and varied. A succinct summary and critique of these points follows.

The following are the arguments in favor of a mandatory "one share, one vote" rule.

Shareholder democracy is essential to confidence in, and the success of, publicly held corporations. While stated with conviction, this argument tends to assume overbroadly both its premises and its conclusion. It also suffers from imperfect analogy to political democracy. Moreover, it fails to answer why such democracy cannot be exercised either to create disparate voting rights or to function thereafter with weighted votes.

A mandatory, uniform rule is needed to prevent a "race to the bottom." Here again, the argumentation assumes, without demonstrating, the value it would seek to uphold. The weight of its conclusion also appears suspect since "one share, one vote" remains the predominant voluntary corporate practice in the absence of any rule whatsoever on most exchanges.

In the absence of such a rule, ownership will become divorced from control. This apparently assumes that a small group, whether composed of management or others, would somehow garner all of the voting securities while the "real" owners would be left without votes. Emotionally, this suggests corporate pillage: in reality, it cries out for a more careful analysis of the concept of ownership. Are voteless lenders owners? Are voteless preferred stockholders owners? Are all commonstock holders owners, regardless of vote or other legal rights? At best, the ownership-control argument appears to wander in inadequately analyzed semantic circles.

In the absence of such a rule, accountability to the owners will be undermined. Here, again, one is presented with the problem of coming to grips with the elusive concept of corporate ownership. Accountability continues, at the very least, to those who remain or become voting owners.

ENTRENCHED MANAGEMENT?

In the absence of such a rule, management will become entrenched. If this argument is meant to suggest a seizure of control or of ownership by insiders, then it describes a matter to be reviewed under the "going private" rules of the commission, not under market regulation rules. If, on the other hand, the argument is meant to suggest that management or insider takeovers are being favored over third-party takeovers, then this would call for a review of the commission's rules under the Williams Act. Neither alternative calls for a market regulation rule.

"One share, one vote" is essential to the preservation of publicly held corporations: these corporations, in turn, are essential to stable employment and community values. This probability overstates both the role and effect of a listing requirement or market-regulation rule. Market-regulation rules are intended to govern those entities choosing to be publicly held, not to dictate which shall and which shall not be so publicly held. Moreover, if the real concern were to preserve public ownership and minimize private ownership, one would expect that advocates of "one share, one vote" would be equally insistent on greater protection against takeovers of all kinds, whether by insiders or by third parties.

Without a "one share, one vote" rule, shareholders will be disenfranchised. Disenfranchisement is a serious matter. However, a "one share, one vote" rule, if responsive at all to the matter, is certainly not indispensable. The "one share, one vote" practice has continued as predominant voluntary corporate practice in the absence of such a rule. State statutes present substantial, although not ultimately preclusive, barriers to disenfranchisement schemes. Disenfranchisement remains a phenomenon to be controlled by legislatures and courts regardless of whether a corporate structure presents uniform voting rights in a single class or disparate voting rights in multiple classes.

The right to vote is an essential attribute of common stock and must not be detached from it. The vote is important. That it should reside always and/or only in common stock—or that common stock votes should always govern—moves beyond proven experience. Must present practices with respect to voting preferred stock, non-voting preferred stock, voting debt securities, etc. be reformed in one direction or the other? May the vote not be exercised to sanction a further class of non-voting common?

Shareholders will be induced to exchange their shares with voting rights for shares without voting rights or for other economic incentives in the absence of a rule. Would this be different from any other inducement to sell shares, whether in the marketplace, in a tender offer or otherwise? Must rules of market regulation assume that stockholders must be protected against some inducements but not others?

COLLECTIVE-ACTION PROBLEMS

Collective-action problems, together with the non-secret ballot, will preclude meaningful shareholder vote on dual capitalization issues unless there is a "one share, one vote rule." The same problems are presumably inherent in the very shareholder democracy sought to be preserved through "one share, one vote." This, however, does not rob the argument of all force and relevance. Rather, it advances discussion to such questions as whether majorities should govern, whether supermajority requirements transfer too much power to minorities (be they insiders or outsiders), etc. Also, concerns of this nature, along with protestations of modesty seeking a secret ballot, are often advanced by large institutional investors and others who would appear to be among the most able, and the least inhibited, in matters of exercising the stockholder franchise.

Abandonment of "one share, one vote" will lead to the bust-up of equity securities and to the "un-understandability," rejection and demise of the American public corporation. The ultimate concern expressed is an important one; prevention of its realization, however, lies not in absolute prohibitions but in understandable gradualism. The same objection was raised, perhaps in overblown fashion, to the fragmentation of common stock rights effected by the unit investment trusts of Americus Shareowner Service Corp. (Americus Trust) two years ago. As with Americus Trust, rules with respect to "one share, one vote" are probably not going to be a determinative factor.

State securities regulators may amend or withdraw exemptions for exchange listed equities if a "one share, one vote rule" is not adopted. Were this to develop, it would not simplify the securities markets. However, it is a bit unclear about what interests would be served thereby and to whom the articulation of the possibility is directed—at the NYSE, at the exchanges that have not previously adopted voting standards, at corporate registrants, at the SEC or at a possible audience in Congress.

In short, while each of the foregoing arguments in favor of a "one share, one vote" rule has a certain level of appeal, each, as indicated, falls short of compelling a mandatory, uniform rule binding on all marketplaces. While similar observations may be made with respect to a number of the arguments opposing such a mandatory, uniform rule, the weight of the arguments against the rule should provide substantial cause to moderate the urge for rule-making.

AGAINST A RULE

Among the arguments against a mandatory "one share, one vote" rule are the following:

There are legitimate business reasons for disparate voting rights, as evidenced by the examples of General Motors Corp., Hershey Foods Corp., Dow Jones & Co. Inc., and others. These case histories, of course, may simply justify limited license for the situations that they typify, and not support the case for carte blanche capital structure.

Capital structure planning should not be restricted by a rule concerning voting rights. Debt-equity ratio concerns may require the raising of capital without adding debt or diluting existing equity voting power. Dividend exclusion and other tax considerations may be relevant to capital structure. And existing preferred, convertible preferred and convertible debt issue already create claims on voting rights. Here, again, the conventional examples cited may prove the case for recognized conventions but not for the absence of any rule whatsoever.

Environmental changes since 1926 make a "one share, one vote" rule no longer necessary. True, conditions have changed. The same old rule may not be needed to address conditions that have disappeared. However, this does not speak to the presence or absence of a need for some form of rule to address present sensitivities or future conditions.

In takeover situations, boards of directors should not be restricted from taking those actions that their fiduciary obligations under state law may counsel them to take in order to protect the stockholders. While this is a most serious consideration, its logic cannot sweep totally aside all (proposed) civil and criminal law restraints on a board's behavior. It does counsel, however, that regulation of a miscellaneous nature ought not interfer.

State law should govern matters of corporate governance and capital structure. Within ~~our federal~~ system, this proposition appears to be legally correct. It will probably remain correct unless and until Congress becomes sufficiently motivated to change the present landscape of this federalism. The question on the other side, however, is whether state law continues to provide sufficient governance in these matters to moot any need for federal legislative or regulatory intervention.

FEDERAL-STATE CONFLICT

State and federal courts are more competent and effective in addressing the abuses that "one share, one vote" arguably seeks to redress. The poison pill has produced its own antidote by inviting courts into the boardroom; lockups are a thing of the past; and courts are scrutinizing directorial protection of stockholders as never before. One may object that this "government by exception" or "government by correction" is inadequate as a governmental * * * our much maligned litigation process appears to have been more prompt, responsive and effective than any other process in responding to the issues at hand, remedying abuses, formulating rules and influencing future behavior.

A mandatory, uniform rule precluding disparate voting rights would infringe stockholder rights to determine capital structure, waive voting rights, purchase securities without voting rights, etc. This argument, of course, states a truism—and one embarrassing to the very concept of stockholder democracy that is involved to perpetrate the infringement. On the other hand, such logic loses force to the extent it assumes that stockholders should never need protection against anything, for the task presented in the present debate is to examine such an assumption.

A rigid, uniform rule would stifle innovation in capital markets. True—but the values of experimentation do not bear with them the logic that there be no bounds.

A rigid, uniform rule would constitute — regulation of securities, not market regulation. While this argument is of particular relevance to the role of the SEC, it might carry less weight in the face of state or federal legislative initiative.

A rigid, uniform market regulation rule would produce an unnecessary federal-state conflict, as fiduciary obligations of boards of directors may oblige them to take conflicting action valid under state law to protect stockholders. This argument rightly points to the desirability of avoiding unnecessary conflicts between federal law and state law. It does not suggest, however, that appropriately limited federal legislation or regulation would not be constitutionally superior to, or preemptive of, corresponding state action.

ANTI-TAKEOVER PROTECTION

A mandatory, uniform "one share, one vote" rule would produce enhanced anti-takeover protection—perhaps the "doomsday machine" of all anti-takeover devices. It is true that if all markets were subject to such a rigid rule, a target company could issue an offending security and thereby make illegal any further market transactions in its common stock. The offending security could not be made substantively illegal without introducing federal substantive corporate law. Moreover, it is not unforeseeable that a prudent board of directors might choose to invoke this "doomsday" scenario in order to halt trading in its stock for a period of time while it sought effective alternatives to protect stockholder interests. Even if private transactions could circumvent the ban on market trading, the resulting chaos would not be a more acceptable evil.

Looking to minor markets or offshore trading as a safety valve would also not be satisfactory, for if these markets were to be reasonably effective as a safety valve, they would also serve as reasonably adequate markets for primary trading in fundamental circumvention of the "one share, one vote" rule. In short, this argument points up the difficult technical task of fashioning a "one share, one vote" market regulation rule that would both prevent the "doomsday" scenario and, at the same time, not provide alternate markets that would undermine the rule itself.

Trading will migrate to offshore markets if a "one share, one vote" rule is adopted. Offshore trading has already developed to a degree. The technologies, communications links and incentives are all there, and the regulatory climate appears conducive. Were restrictive market regulation rules in the United States to provide sufficient impetus, the real losers in a surge of offshore trading would be the U.S. marketplaces and any standards imposed by rules in those marketplaces that might thereby be circumvented.

Predominantly voluntary corporate practice currently observes the "one share, one vote" practice. But to what extent has this been influenced by the existing rules of the New York and Pacific Stock Exchanges? In the current environment, is the past truly prologue?

There is no clear need for a mandatory, uniform "one share, one vote" rule. On the basis of logical argumentation, perhaps not. But, as noted below, there is more to law than logic.

Broad, easy, rigid rules create more problems than they cure. SEC disclosure rules already serve the values of understandability and of fairness that underlie "one share, one vote." Any further regulation should be in keeping with the experimental, common-law approach which only fixes that which is broken. This argument reformulates the absence of a need for regulation. And the relevance of "need" in matters of broad social debate is, as suggested below, often open to question.

REQUEST FOR COMMENTS

The SEC's request for comments asked: Even if a uniform policy is developed, should certain types of companies or situations uniformly be exempted from such a policy?

A uniform rule with exceptions would represent a compromise between the debating factions: proponents of a "one share, one vote" rule would find sufficient practical accommodation among the exceptions to the rule. From the standpoint of the regulator, the result would represent not compromise but prudent rule-making.

The SEC release indentified four possible exemptions:

Companies that had disparate voting rights at the time the company first became publicly owned (also incorporated into the NYSE rule change).

Companies that in connection with providing venture capital to small or medium-size businesses acquire control of those businesses.

Growth or unseasoned companies.

Stock issued in connection with a merger, the payout of which is related to the underlying transaction (e.g., the issuance by General Motors of common stock classes E and H having different voting and dividend rights). At the hearings and thereafter, in response to questioning by the commissioners, additional categories of exemption were suggested.

Issues that are first offered preemptively to existing stockholders or that offer lesser voting rights to new investors.

Grandfathered situations—to be identified in the comment process for either accommodation in the rule or ad hoc exemption.

Issues authorized by boards of directors in the exercise of their fiduciary duties to protect stockholders (particularly in takeover situations), which issuances are redeemable or reversible in the exercise of the board's fiduciary powers (akin to the redeemability of poison pills).

Issues approved by independent directors and by public stockholders.

FAMILY INTERESTS

The last suggested exemption, of course, restates as a substantive exemption the procedural conditions set forth in the NYSE rule change under review.

The comment process further identified factors that might be expected to be included within the first category of exemption above: continuing family interests in the business; business mission heavily dependent on the founders (e.g., BDM Corp.);

quality or reputation of the name or product (e.g., the J.M. Smucker Co.); and charitable purposes of controlling founders (e.g., Hershey Foods).

The comment process further pointed out that the fourth proposed exemption category should probably be broad enough to include all issuances that are made for the special needs of acquisitions, divestitures of special purpose financings where the securities issued relate in a meaningful way to the underlying transaction.

The logic of the arguments proferred to date, if such be relevant, would appear to incline away from imposition of a mandatory "one share, one vote" rule on all markets, with or without exemptions. In this context, the absence of a demonstrated need for such a rule is given proper weight.

However, none of the arguments for or against "one share, one vote" may ultimately be important in the disposition of the controversy. Such arguments may, at best, be imperfect reflections of the underlying agendas they represent.

The underlying dynamics, meritorious or otherwise, that may ultimately drive the disposition, woud appear to include the following:

The continuing struggle over corporate control. "One share, one vote" is simply one more battleground, however, important or unimportant, in the many-sided struggle with respect to tender offers, takeovers and contests for corporate control. Proponents of more facile trafficking in the control of corporations tend to favor "one share, one vote," presumably because it limits the options of a board of directors in fashioning a recapitalization of other plan to protect stockholders in response to an unwelcome takeover overture. Opponents of inadequate takeover bids, on the one hand, tend to favor the flexibility that a relaxed "one share, one vote" rule would allow a board of directors in such a situation.

The absence of stewardship responsibility of corporate owners. One may not drive an automobile, fly an aircraft or own a piece of real property without stewardship responsibilities of a legal nature. The same is not true of ownership of stock in a corporation. Precisely because of this, the dynamics of analysis and of change focus on corporate managers or on government regulators as the only parties charged with responsibility. Past, present and future owners of corporations are permitted to come and go with no responsibility whatsoever. The absence of stewardship responsibility is conducive both to conventional investment of programs and to trading and manipulating corporate ownership and control. It also creates a "responsibility gap."

Because there are sufficient legitimate reasons to maintain both the corporate form of ownership and its ready transferability for investment purposes, the periodic societal attempts to remedy this "responsibility gap" must take the form and direction of seeking to regulate other actors—actors who did not create the gap, who are ill-equipped to deal with it and/or who can respond affirmatively to it only by curtailing rights or processes that otherwise ought to be permitted to operate freely. Where such regulation is enacted, the net effect is that those who benefit from the "responsibility gap" succeed in shifting its burden onto others.

Public clamor. Regardless of the merits or direction, the fact of real or apparent public clamor, whether or not related to the foregoing, often constitutes its own need to be dealt with.

Political pressures. The foregoing dynamics are sufficiently well represented in the political arena. The specter of possible legislative reaction has been known to have a behavioral impact on private parties and government agencies alike.

COMMISSIONERS' QUESTIONS

At the public hearings in December, the questions from the commissioners focused frequently on the SEC's jurisdiction in the matter. From this it has become apparent that no matter how strongly moved one or more commissioners may be to achieve a reasonable disposition on the merits, there is little appetite for exceeding the bounds of commission jurisdiction in such a manner as to set bad precedent for future commissions.

Further, and without repeating the detailed legal arguments on both sides of the question of jurisdiction, it seems safe to draw the general conclusions that if there were a crisis in the securities markets requiring a rule of market regulation—a rule that incidently affected, directly or indirectly, matters of corporate governance—jurisdiction might well be found. However, prescription of corporate governance criteria unrelated to a bona fide market regulation need would probably be viewed as beyond the commission's charter.

Federal legislation, then, would appear to be surer path—either for augmenting the commission's jurisdiction or for disposing of the controversy on its merits. The very thought of federal legislation regulating the capital structure or governance of corporations, however, raises the immediate concerns of lack of need, lack of expertise and possible constitutional crisis.

State legislatures must, by all parties, be recognized as jurisdictionally competent to address the issue. However, the state legislative process appears unlikely to step into the fray, either for lack of support for imposing a "one share, one vote" rule or for fear that any such change might signal a hostile environment for business.

All of this brings attention full circle back to the SEC and to the application for approval of the rule change that has touched off the current national debate. It is ironic that so much of the criticism in the present debate seems to have been directed at the NYSE, which has, for 60 years, been the pre-eminent champion of "one share, one vote"—and seeminly not at all at the other exchanges and marketplaces, which have had no such role at all. Moreover, as pointed out above, mere denial of the NYSE application, without imposing a uniform rule on the other markets, would be both futile in policy and punitive against the NYSE.

THREE OPTIONS

One option for the commission is to conclude that due to the bounds of its own jurisdiction and the lack of a clearly compelling alternative, the appropriate course is to approve the NYSE rule change, and not to engage in broader rule-making.

A second option for the commission is to stay its hand pending the outcome of renewed private sector initiatives to reach agreement on the matter. The NASD's public reversal of its position (in its March 13 letter to the SEC suggesting "that all equity securities markets should have a uniform rule for domestic securities emphasizing the principle of equal voting rights but allow for legitimate variations") signals at the very least the possibility that earlier NYSE initiatives seeking voluntary agreement among markets may yet bear fruit, permitting the SEC to orchestrate or bless a pragmatic solution without exceeding the bounds of its own jurisdiction.

A third option for the commission is to continue to hold the applications of the NYSE and Amex in abeyance while it publishes for comment a proposed uniform rule for all markets, with appropriate exemptions. This would permit fresh and precise examination of: the question of the commission's jurisdiction; the need for having such a rule in any form; exemptions and grandfathering; and the practical effects of such a role.

The first option would represent a conservative, non-interventionist response, leaving free markets and self-regulatory agencies to sort out such problems as might arise. It might also leave enough constituents sufficiently dissatisfied to cause the debate to migrate to another forum.

The second alternative has significant appeal. If the self-regulatory organizations can advance the discussion among themselves, a more satisfying breadth of consensus may result; and the role of the commission in approving the resulting rule change proposals would probably be less controversial.

The third alternative—perhaps more likely than the first, if the second should fail—would continue the debate full-blown. At the same time, it would provide additional opportunity to gain actual operating experience with respect to those corporations that already have dual-class capitalization—to see whether, in fact, they operate in such a way that they require regulatory redress at all.

As of this writing, the second alternative has been in some degree of operation for several months. It is too early, however, to conclude that agreement may be reached among the parties. On the one hand, the rule change proposed by the NYSE would condition unequal voting rights upon approval by a majority of the issuer's independent directors and public shareholders, and would place limitations on grandfathering.

The March 13 letter from the NASD, on the other hand, suggested significantly broader possibilities for unequal voting rights. Its rule "would emphasize the princple of equal voting rights but allow for legitimate variations" and the variations would appear to include all situations involving either a registered public offering or a merger, acquisition or recapitalization accompanied by proxy material, where there is full disclosure. Also, there would be "a general grandfather clause in perpetuity." Somewhere between the positions of the NYSE and the NASD are the several exceptions listed earlier in this article.

By late April, a summary of a proposed uniform voting rights rule had emerged from discussions among representatives of self-regulatory organizations and of the SEC. The SEC requested that the NYSE, Amex and NASD bring the proposal to their respective boards during May. These organizations, in turn, sought comments from their constituents. Derivative proposals also were developed.

As of the end of May, the SEC decided not to commence its own rule-making proceedings (option three), thereby providing additional time for the self-regulatory organizations to reach voluntary agreement.

In the first week of June, however, efforts to reach voluntary agreement stalled, with the Amex reportedly advocating fewer exceptions than those contained in a compromise proposal that apparently had the support of the NYSE, NASD and SEC staffs.

A DEGREE OF CONSENSUS

Accordingly, the SEC voted June 11 to commence its own rule-making proceedings with respect to a minimum voting rights standard that would prohibit the nation's stock markets from listing companies that take "corporate action" to nullify, restrict or disproportionately reduce the voting rights of existing shareholders. Grandfathering and certain exceptions, including new issuances with lesser voting rights, would be allowed. Hearings will be held in late July.

As the summer wears on, negotiations among the exchanges will undoubtedly continue, against the background of the SEC rule-making proceedings. By mid-summer it should become clear whether the self-regulatory organizations will be able to achieve a substantial degree of consensus and whether, in turn, this consensus will be sufficiently responsive to the needs of the present debate to moot the SEC proceedings.

If so, it can be expected that these organizations will by late summer submit their proposed rule changes to the SEC for approval. If not, it can be expected that the SEC will proceed to a conclusion with its pending rule-making proceedings.

NOTES

(1) The text of the rule change, as submitted by the New York Stock Exchange for approval is as follows: New York Stock Exchange Inc., Proposed Rule. [Additions are denoted within brackets.] Sec. 313.00 of the New York Stock Exchange Listed Company Manual would be modified through: amendments to existing Paragraphs 313.00(C) and 313.00(D), the addition of new Paragraph 313.00(E), and redesignation of existing Paragraph 313.00(E) as Paragraph 313.00(F) . . . 313.00

Voting Rights. (A) Non-Voting Common Stock. Since 1926, the Exchange has refused to authorize the listing of non-voting stock, however designated, which by its terms is in effect a common stock. This restriction would not apply to the listing of non-voting common stock of quasi-governmental corporations where, by reason of legislative or judicial mandate, the issuance of voting stock to the public is restricted. The Exchange will also refuse to list the common voting stock of a company which also has outstanding a non-voting stock, however, designated, which by its terms is in effect a common stock. In line with the above, the Exchange normally will refuse to list voting trust certificates. Exception has been made in the case of voting trusts established pursuant to reorganization proceedings under court direction. (B) Restrictions on Voting Rights Through Voting Trusts or Similar Arrangements. The Exchange would object to transactions where the voting rights of shareholders have been restricted by the use of a voting trust, irrevocable proxy, or any similar arrangement to which the company or any of its directors or officers is a party, either directly or indirectly. The Exchange would neither approve the original listing of a company where the above mentioned provisions exist nor authorize the listing of additional shares of such a listed company. (C) Unusual Voting Provisions. Creation of a class of stock which has unusual voting provisions which tend to nullify or restrict voting, or which subject the common stock to the unusual voting provisions of that class of stock, could affect the continued listing status of the company, except as provided by paragraph (E) below. A situation in which one class of stock has the right to veto the actions of the common stock is an example. The Exchange may refuse to list a class of stock which has unusual voting provisions except as provided by paragraph (E) below. (D) Proportionate Voting Power. Except as provided by paragraph (E) below in cases where voting power is divided between the common stock and one or more other classes of stock under normal conditions (as distinguished from conditions under which such other class or classes temporarily acquire voting power as a result of dividend default or some other similar occurrence) the Exchange, when considering the listing of the common stock, will take into account the relationship between the proportion of the total voting power represented by such other class or classes and their relative equities in the company. The circumstances under which different classes of stock are issued, their priorities and preferences, and their equity interests are so varied that the Exchange has not found it feasible to fix standards as to what constitutes the appropriate apportionment of voting power as between different classes of stocks. Therefore, each case must be considered individually. However, the Exchange is of the view that [subject to paragraph (E) below] any allocation of voting power under normal conditions to classes of stock other than common stock should be in reasonable relationship to the equity interests of such classes. If the voting power of such other classes is in excess of such reasonable relationship, the Exchange may refuse to authorize listing of the common stock. (E) Approval of Voting Provisions. Subject to the provisions of paragraphs (A) and (B) above, the Exchange will allow a class or classes of common stock having other than one vote per share and a class or classes of voting equity securities which would otherwise be objectionable under paragraphs (C) or (D) above (each such class of common stock or of voting equity security being referred to in this paragraph (E) as "disparate voting rights stock"), provided that the specific voting provisions of such securities have been approved by a majority of the independent directors of the issuer; and by a majority of the votes eligible to be cast by the public shareholders. (Public shareholders are defined as beneficial owners of the issuer's voting equity securities who are not directors, officers, or members of their immediate families or their affiliates, or affiliates of the issuer. For the purposes of this paragraph (E), the term "affiliate" is as defined in the regulations promulgated under the Securities Exchange Act of 1934.) Listed companies that created, between April, 1984 and (date SEC approves modification), a class or classes of disparate voting rights stock without having obtained the approval referred to in (a) and (b) above, must do so by not later than two years after (date SEC approve modification). Any class of disparate voting rights stock shares of which were outstanding at the time the issuer thereof had a class of equity security held of record by 500 or more persons will not be subject to the approval referred to in (a) and (b) above. Any class of disparate voting rights stock shares of which are first issued after the issuer had a class of equity security held of record by 500 or more persons will be subject to the approval referred to in (a) and (b) above. Companies seeking to list and having outstanding any class of disparate voting rights stock, the voting provisions of which are subject to the approval referred to in (a) and (b) above, must obtain such approval prior to listing. Where a company distributes pro rata among its common shareholders shares of disparate voting rights stock issued by a company other than the distributing company or a successor company the voting provisions of such disparate voting rights stock will not be subject to the approval referred to in (a) and (b) above. (F) Preferred Stock. Minimum Voting Rights Required.

(2) Application for approval of the American Stock Exchange rule change is also pending before the Securities and Exchange Commission. Both the fact of this rule change and the positions asserted by the Amex on the "one-share, one vote" issue must be understood in terms of the situation in which the Amex finds itself—somewhere between the NYSE which has applied for approval of its modified rule and the NASD which has no rule at all (but recently has announced a change in viewpoint).

(3) SEC Release No. 34-23803, Nov. 13. 1986.

The CHAIRMAN. Well, thank you, gentlemen, for brilliant testimony. I think it's been most impressive.

Mr. Sommer, I think you probably heard Senator Wirth ask what I think was a very critical question at the end. He said the one remaining problem he had is the multiple class stock recapitalization, the argument that they are inherently coercive on a company's stockholders.

I take it you've answered that question in your testimony very emphatically when you say that in every single State it's required that stockholders vote by State law. Is that right?

Mr. SOMMER. Yes, sir.

Senator ARMSTRONG. Mr. Chairman, excuse me. Before Mr. Sommer elaborates, could I address the committee for a moment?

The CHAIRMAN. Certainly.

Senator ARMSTRONG. I find myself in an awkward situation for time. I'm very reluctant to leave, but I'm now in a situation where I must excuse myself.

The CHAIRMAN. If it's all right with Senator Shelby, can we permit Senator Armstrong to go ahead?

Senator ARMSTRONG. I'm not seeking to be recognized. I just wanted to explain to the witnesses.

Senator SHELBY. I would love to recognize him, Mr. Chairman.

Senator ARMSTRONG. No, I really don't want to, except to say that I appreciate the testimony, which was very skillful, and to point out, as I did in my opening statement, that there is a great distinction between the Adolph Coors Co. and other companies that are represented here today.

I have no problem with a company which in its initial public offering says, "We're selling investment, not control." I do have a problem with companies which make that decision later, even though, Mr. Hechinger, by a large margin. I understand that in your case that it was by a large margin and I don't criticize you or your company. But the principle of changing the rules after the fact disturbs me.

Mr. Chairman, reluctantly, I am going to excuse myself to fulfill another commitment for which I expect I'm already late.

The CHAIRMAN. I understand. This was Colorado Day. We had Mr. Coors. We had Senator Wirth. And we had Senator Armstrong. Mr. Coors, I think you were very convincing.

Mr. Sommer, did you want to add anything to that?

Mr. SOMMER. Yes, I would add just a little bit. It seems to me the evidence is lacking that there has been any harm inflicted upon shareholders. Now the charge is made and the suggestion was made during the previous testimony that a variation of one share/one vote inhibits the possibility of a tender offer. That goes to the question of whether hostile tender offers, of course, are good for society or not. I'm not going to debate that in this forum at this time.

Again, I would emphasize the fact that these measures are taken by the shareholders. And while Senator Armstrong distinguishes the case of a company going public with a lower voting stock as in the case of Coors from that of Mr. Hechinger where they recapitalized, the net result is the same. The shareholders make a decision. They make an investment decision. Do they want to be investors in a company with this? If they do, they vote for it and they keep their investment. If they don't want to, they vote against it and if it carries, then they're free to sell their stock and, as I say, they don't do it at a disadvantage pricewise, and invest in something else.

The intriguing thing to me, Senator Proxmire, is that the people who are the strongest advocates of preserving the right of shareholders to vote are the ones who would deny them the right to vote on the most important thing, the capitalization of their company. And I simply cannot fathom that.

The CHAIRMAN. It's very, very hard for me to fathom, too. It just seems to me that, No. 1, we should be very reluctant to interfere with corporate activity unless there's a clear abuse of some kind. We treasure and prize the freedom we have in our economic system. We ought to encourage that. We shouldn't interfere unless there's a very strong case for it.

No. 2—I think you said it very well—we have a long, long tradition and a successful tradition of State regulation of corporations, States setting the pace for it, States determining how corporations can operate. Of course, mandating a one share/one vote standard would preempt and take over and interfere with that. It would, you say, impose a congressional view instead of a State view.

So for both those reasons it seems to me that this would be a mistake.

Mr. Coors, you contend in your testimony there are legitimate beneficial reasons for some companies to offer investors multiple classes of stocks with disparate voting rights.

You note on page 5 of your testimony that having such a system has enabled your company to stay out of debt and finance its growth with internally generated funds. This you claim has enabled your company to survive lean years when 800 of your brewing competitors did not.

EFFECTS ON CORPORATE POLICY OF FINANCING GROWTH

Why would a mandated one share/one vote standard force you to change your corporate policy of financing growth out of internally generated funds?

Mr. COORS. Well, in our situation, when we were forced to settle the estate, we would have had to borrow hundreds of millions of dollars in order to buy back the personal shares owned by the estates of the deceased, to pay taxes. Those hundreds of millions would have been on our books. We may or may not have been able to service that debt, but it certainly would have been a major burden in a highly competitive marketplace and it definitely would have restricted our ability to invest those same dollars into our growth.

The CHAIRMAN. Mr. Hechinger, you point out in your statement:

> Those who argue for the analogy between one man/one vote and one share/one vote misunderstand the concept of the corporation as an economic institution, not a political institution.

You go on to say:

> We cannot confuse political voting rights with privileges arising from a contractual business relationship.

Can you state as clearly as you can why one share/one vote should not be equated with motherhood, civil rights, apple pie, or political equality?

Mr. HECHINGER. Owing a share of stock is an economic contract between the corporation and the stockholder and, as Mr. Sommer, pointed out so clearly, the fact is an individual has a choice. If that prospective stockholder doesn't like the Hechinger stock because of the fact that the Hechinger has two classes of stock and believes the disparate voting rights of Hechinger stock reduces its value, they have the choice of not buying in the first place or selling if they own and investing elsewhere. It is that freedom of action which is different from the political right of having an ability to select between one candidate and another on an equal basis with every other citizen. Disfranchising people by having some other standard like having a poll tax or denying women from full voting rights is to corrupt the constitutional guarantee of the inalienable democratic right of full citizenship.

The proposition of being able to select, choose and determine the direction of your investment is not analogous to one man/one vote in the political sphere.

The **Chairman**. Thank you, sir. My time is up.

Senator Shelby.

Senator **Shelby**. Thank you, Mr. Chairman.

I know Mr. Coors has got to get out of here. We'd all like to. Mr. Coors, I want to ask you this.

Under most of the one share/one vote proposals that have been floating around and talked about some today, your company would be grandfathered in under a lot of these proposals to cover you presently. Some of the proposals would even go a little further and allow you to continue to do pro rata offerings in the future.

WOULD GRANDFATHERING HELP?

If we pass legislation—and I hope we do—in the Congress that would grandfather in some of these companies like yours and Mr. Hechingers and General Motors, et cetera, that are already out there, that have already done this, would that still give you grief?

Mr. **Coors**. Well, it certainly would protect us.

Senator **Shelby**. That's right.

Mr. **Coors**. But I'm concerned about the person who is coming to America today and invests whatever he has—maybe his $10,000—into a company that becomes something and because of death and inheritance taxes he has to deal with our same issues in the future. Why should we prevent him from structuring his company the same way that we're allowed to do?

Senator **Shelby**. What about the shareholder? The concept of the shareholder not being able to vote has always bothered me tremendously and it's bothered a lot of people here. Do you believe that the average purchaser—the average purchaser—of the class B stock realizes at the time of the purchase that class B stock is non-voting?

Mr. **Coors**. Yes. Well, it certainly was in our prospectus and other filings.

Senator **Shelby**. It depends upon the degree of someone being informed and they should be?

Mr. **Coors**. We have a major number of institutional investors in our stock and I believe those people very definitely know the voting nature of that stock.

Senator **Shelby**. They're sophisticated investors, but what about the average investor, not sophisticated, off the street?

Mr. **Coors**. We have not done a survey of that.

Senator **Shelby**. Mr. Hechinger, when your company went public, you in essence, like everyone, you bring in thousands of partners of shareholders in the operation.

Did you basically intend not to give them a voting right or a share in the company? Is that what you really had a two-class or dual ownership situation for, where you could control the management and they couldn't have anything to do basically about the management?

Mr. **Hechinger**. Senator Shelby, when we went public, it was printed in the proxy the amount of stock that was owned by the then existing stockholders and in our case it was the family that owned a majority of that stock. So as people bought shares of stock, they realized that they were not buying absolute control. They knew that the total shares of available stock was only 15 percent of the vote. They were buying in to what they visualized as a growing, profitable company and were eager to do so—large institutions were willing to do so knowing that less than 51 percent would have afforded the stock purchasers control, they bought less.

Mr. COORS. Mr. Chairman, may I be excused?

The CHAIRMAN. Of course, yes.

Senator SHELBY. We knew you had to get out of here.

Mr. COORS. Thank you.

Senator SHELBY. Thank you for coming.

The CHAIRMAN. I've been worried about that. I hope you make your plane.

Senator SHELBY. Mr. Sommer, in the past you stated that the SEC's proxy rules operate as a "governor on the conduct of management."

How can this governor work if management recapitalizes and takes away effective voting rights for stockholders?

Mr. SOMMER. The proxy process, of course, makes public a lot of things that otherwise would not be publicly known. The pressures on management do not come solely or even principally, in my estimation, from the presence of shareholders with a vote. The pressures on management—and I think this can be documented every day in the Wall Street Journal—come from publicity about misconduct, they come from financial analysts who criticize management, they come from investment and commercial bankers who put pressure on management to maximize the profitability of the enterprise. You read every day in the Wall Street Journal of managements being displaced. Rarely do you read of one being displaced, other than as a consequence of a tender offer—and those are relatively few even today—because of a voting rebellion on the part of shareholders.

The proxy process makes sure that all of these other people who potentially may influence the course of management's conduct are informed with regard to what's happening.

Senator SHELBY. Do you basically agree that a share of stock represents a share of ownership in a corporation?

Mr. SOMMER. Yes, it does.

Senator SHELBY. Shouldn't it have a voting right with it?

Mr. SOMMER. Not necessarily. Preferred shareholders represent a share in the corporation and a share in the profits and they don't have a vote.

Senator SHELBY. Do you think it's equitable not to have a shareholder voting right?

Mr. SOMMER. Pardon me?

Senator SHELBY. Do you believe it's equitable to the shareholder—in other words, fair—not to have the voting right?

Mr. SOMMER. I think it is, sure.

Senator SHELBY. You do.

Mr. SOMMER. I own stock in companies where I have very little minority voting power.

Senator SHELBY. Who are you representing here today?

Mr. SOMMER. Me, myself and I.

Senator SHELBY. No one else?

Mr. SOMMER. That's right.

Senator SHELBY. Mr. Troy, I have a couple questions if I've got time.

Do you support in principle the creation of a uniform one share/one vote standard?

Mr. TROY. No.

Senator SHELBY. You don't?

Mr. TROY. We truly espouse the value of understandability and the fairness that you may often get with that, but we see those values also available in more complex situations.

Senator SHELBY. What exceptions would you consider appropriate and fair?

Mr. TROY. Well, if you were to have a rule and let's assume we're talking about a rule which——

Senator SHELBY. Sure. Let's adopt a rule and talk about exceptions.

EXCEPTIONS TO THE RULE

Mr. TROY. There are a good dozen or so exceptions which would include your existing situations, of course, family situations, venture capital situations, new and emerging companies that may need control mechanisms, family situations, certainly the New York Stock Exchange proposed situation which would involve those capital structures which are in fact approved by the public stockholders and by the independent directors. Clearly we need an exception for the directors of publicly held corporations to take those actions that they may have to take in a takeover situation in order to protect their stockholders against what may be something not in their best interests, which they may be precluded from doing if there is a rule which says you can't quite have a pill structured that way or you can't do a recapitalization that way. There are 12 or 13 different exceptions I think should be in such a rule and they are contained and set forth in the written statement I submitted to the committee.

Senator SHELBY. Mr. Chairman, my time has expired.

The CHAIRMAN. I do have one question for Mr. Troy. Maybe the other panelists can help on this.

Did I understand you to say that if we passed the proposed amendment mandating one share/one vote—it seemed like a bolt of lightning to me—that it would stop takeovers because the firm would get delisted rather than proceed?

Mr. TROY. What a target company could do is simply create an issue with disparate voting rights, an offending security. Under the new law, that means all of its common stock could no longer be traded in any public marketplace.

Now this issue has been around and been discussed for well over a year now and the only proposed solution to it is, well, we won't make the one share/one vote rule apply to all marketplaces; we'll leave an escape valve marketplace. But as soon as you leave an escape valve marketplace you've circumvented the rule to begin with. In short, it's a terribly difficult thing to deal with and I've yet to hear proposed the true antidote to that "doomsday" scenario. I do not think you want a rule, whether it's from this Congress or from the Commission, that creates such power to create such a situation.

The **Chairman**. Mr. Sommer, do you agree with that?

Mr. **Sommer**. I can see that scenario happening. I suspect that if it ever did the Congress would be quick to act to put a plug in whatever the loophole appeared to be.

The **Chairman**. I beg your pardon, Senator Shelby.

Senator **Shelby**. Mr. Chairman, I'll be brief. Do the three of you believe that Congress ought to make public policy, whether it's dealing with this issue or with most issues?

Mr. **Sommer**. Within limits, Senator. I would not say all public policy.

The **Chairman**. Only the right public policy.

Mr. **Sommer**. Only the right public policy, but there are areas of public policy that are left to States and I believe that it's a sophisticated judgment and a constitutional judgment as to which areas should be left for policy determination by the States and I think this is one of them.

Mr. **Troy**. I do, also, with the concept of limitation that I wouldn't want to see public policy made to enhance stockholder rights which really abrogates them. It's a little bit like saying we're so concerned about your constitutional right to free speech that we will guarantee it by legislating the following 100 categories on which you may speak. You see the obvious analogy.

Senator **Shelby**. Sure.

Mr. **Hechinger**. I certainly agree Congress should make public policy and I think the major thrust of the arguments you've heard today is make policy, but don't make this bad policy. And whereas it has been historically an area in which the States legislate, therefore we recommend that it stay there, nevertheless, I do agree Congress can legislate here and in other areas in which the national interests should be dominant. I favor national gun legislation—a very controversial subject. I believe there should be a national policy.

I think our recommendation is that on legislating a prohibition of dual classes of stock you have chosen the wrong side of the issue.

Senator **Shelby**. Do you believe that a weighty subject would be the shareholders' right in publicly traded corporations is an issue for public policy? You don't agree that that is an issue for public policy, yet gun control would be?

Mr. **Hechinger**. I'm saying that—I'm not disagreeing that there is an argument that you have the right to legislate and it may be good to legislate in this area.

Senator **Shelby**. That's what I'm asking you.

Mr. **Hechinger**. But I'm telling you that you are on the wrong side as you set out to legislate—the position you've chosen is bad.

Senator **Shelby**. Because it affects you and the way you look at it, right?

Mr. **Hechinger**. Well, because the way you look at it is incorrect.

Senator **Shelby**. But what it is, you have a personal interest in it in your company and that's why you're here today, isn't it, Mr. Hechinger?

Mr. **Hechinger**. Well, it's also——

Senator **Shelby**. Answer the question. Is that right?

Mr. **Hechinger**. Yes, it is because of this entrepreneurship which I——

Senator **Shelby**. It is because you have a personal interest in it and the way your company is capitalized is why you have an interest in being here today, right?

The **Chairman**. What's wrong with that?

Senator **Shelby**. I didn't say there was anything wrong with it, Mr. Chairman. I want him to answer the question.

Mr. **Hechinger**. The answer is yes, of course.

Senator **Shelby**. That's right, an obvious yes.

Mr. **Hechinger**. An obvious yes, but it allows us to see a little broader than our personal interest, preventing dual classes of stock at this moment in America, where you see the kind of voracious takeover attempt causing the collapse of the fine company, Safeway. This kind of unfriendly takeover makes this issue generic one.

Senator **Shelby**. But there are two sides to that issue, too, isn't there, your side and the other side?

Mr. **Hechinger**. Well, of course.

Senator **Shelby**. Thank you.

The **Chairman**. I do have one—I hesitate at this late hour, but, Mr. Sommer, in your judgment, as a former SEC Commissioner, does the SEC now have the right to promulgate rules in this area?

Mr. **Sommer**. I do not believe they do, but obviously that's a contested issue and they apparently believe that they do, but I don't.

The **Chairman**. Thank you. Thank you, gentlemen, very, very much. I appreciate so much your patience and your excellent testimony.

The committee will stand in recess.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

[Additional material for the record follows:]

ACG

ALLIANCE FOR CORPORATE GROWTH
Suite [illegible] 1828 L Street, N.W.
Washington, D.C. 20036
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SELECTED EXCERPTS

FROM COMMENTS FILED WITH THE SEC

IN SUPPORT OF DISPARATE VOTING

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AMERICAN FAMILY CORPORATION
Columbus, Georgia
December 2, 1986

American Family Corporation ("AFC") supports the proposed rule which would establish approval requirements which would permit the listing on the NYSE of disparate voting rights stock. AFC believes that the NYSE's decision to permit the listing of disparate voting rights stock which receives the approval of a majority of a company's independent directors and a majority of the votes eligible to be cast by a company's "public shareholders" is consistent with the NYSE's duties under the Securities Exchange Act of 1934 and is in the best interests of NYSE-listed companies and their stockholders.

AFC believes that the Commission should give great weight to the fact that AFC's stockholders, as well as stockholders of other NYSE-listed companies, have adopted disparate voting rights despite the potential negative consequence of delisting. AFC's stockholders made the decision that the benefits provided by disparate voting rights outweighed the negative effect of potential delisting. After considering the implications of stockholder decisions adopting disparate voting rights, the NYSE determined that stockholders of NYSE-listed companies should not be prohibited from exercising self-determination on the issue of stockholder voting rights. AFC urges the Commission to reach the same conclusion.

In recent years short-term, speculative investors have exercised significant influence in the governance of publicly-traded companies. This has caused some companies to be overly concerned with short-term performance at the expense of the long-term best interests of such companies.

AFC's disparate voting rights provisions are intended to encourage persons seeking to acquire control of AFC to initiate arm's-length negotiations with AFC's Board of Directors and executive officers . . . Because of the stability provided by AFC's disparate voting rights, AFC's officers and directors are in a strong position to respond to any proposed takeover with a course of action which they believe to be in the best interest of AFC and all of its stockholders.

While AFC does not oppose reasonable NYSE listing standards more stringent than state corporation laws, AFC believes that government regulation of stockholder voting rights should be left entirely within the domain of state corporation laws. It is AFC's view that any attempt to prohibit or to make unreasonably burdensome the adoption by stockholders of disparate voting rights provisions would represent an unjustified interference with state regulation of corporate charters.

— John B. Amos
Chairman & CEO

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.
Washington, D.C.
December 17, 1986

The Society is in agreement that the Securities and Exchange Commission ("Commission") should approve the application of the New York Stock Exchange ("NYSE") to amend its listing standards to permit the elimination of the "one share, one vote" rule. Such approval would, in the judgment of the NYSE, permit the NYSE to remain an attractive market place to the substantial American corporations which have chosen to list their shares there and would allow the NYSE to remain competitive with such other major market centers as the National Association of Securities Dealers, Inc. ("NASD") and the American Stock Exchange ("Amex"). The Society supports the judgment.

Over the years, of course, companies have issued preferred stock with rights, preferences and privileges, including voting rights, quite different from those of their common stock, and we understand that shares of such preferred stock have been listed on the NYSE so long as they have not granted more than one vote per share to the holder. There would thus appear to be no logical reason why shares of a second class of common stock having voting rights no greater than those of the first class should not similarly be so listed; and nowadays valid market and business reasons may well exist for the issuance and listing on the NYSE of other classes of common stock having voting rights greater than those of the first class of common stock.

Further, as a result of the permitted exclusion of 85% (80% in 1987 and thereafter) of corporate dividends received by another corporation in calculating the latter's income for federal income tax purposes, corporations which distribute their securities to the institutional corporate markets may find it advantageous to issue equity rather than debt securities, and these companies should have the flexibility to issue such equity with such voting rights as may be acceptable to both buyer and seller.

The environment in which the NYSE currently operates is far different from that which prevailed when its listing and disclosure requirements were first adopted. Federal and State governments, the Commission and the Financial Accounting Standards Board now impose disclosure standards that are believed to be adequate for the protection of investor interests.

Adoption of this view would result in state law governing a corporation's actions in this area, which is believed to be appropriate. We note that state law generally requires a shareholder vote to amend the articles of incorporation to authorize the creation of a new class of voting securities and that such action may be presented for shareholder action only upon approval of the board of directors. Many members believe it appropriate for state law to determine the specifics of these procedures, since, in their view, state law reflects a reliable balance of various interests that has evolved over time and is accepted as the ultimate regulator of all corporations, whether they are listed on the NYSE or not . . . The proper role of the Commission should be to ensure full disclosure with respect to the creation of a new class of securities in the proxy statement used to obtain shareholder approval of a recapitalization or in the appropriate disclosure document if the company goes public with more than one class of voting securities, so that shareholders or investors will be fully informed of the capital structure of the company and may make their voting and investment decisions accordingly.

* The society's 2,900 members, representing over 2,200 corporations in the United States and Canada, are regularly involved in such matters as corporate governance, the regulation and trading of securities, proxy solicitation and other shareholder activities, and the administration of the office of the corporate secretary.

AMPAL AMERICAN ISRAEL CORPORATION
New York, New York
December 5, 1986

The fundamental aspect of federal regulation of the securities markets has been to provide expansive disclosure to the market place in order to allow investors to make decisions relating to corporate investment on a fully informed basis. However, the capitalization structures of corporations, the relationships of Boards and shareholders to one another and to the corporate entity have traditionally been areas regulated by state chartering laws. State legislatures and courts have developed an expertise in the area of corporate governance which should not be lightly thrown aside by federal intervention in this area. Although Congress has authorized the Securities and Exchange Commission to establish a national market system, it is highly unlikely that Congress anticipated that in an effort to do so the Securities and Exchange Commission would attempt to preempt fundamental concepts of state corporate law in the process.

Michael Arnon
President & CEO

BDM INTERNATIONAL, INC.
McLean, Virginia
December 16, 1986

The proposal of the New York Stock Exchange, to permit the listing of stock having disparate voting rights, is a reasoned response to the dynamics of the marketplace for capital. The one share, one vote listing requirement is an impediment to competition among the various Exchanges. Further, this requirement has constrained many companies from competing for capital on the nation's leading auction market.

The NYSE listing standard, requiring that each share carry an equal vote, has been distorted by the presumption that effective and efficient corporate decision making requires the essentials of our democratic political system. This is simply not the case. Corporations are investment vehicles for their shareholders, not political systems . . . The diversity of firms having disparate voting structures and preferential treatment accords additional investment choices to the investor.

Public shareholders wishing to invest in BDM have available all Securities and Exchange Commission mandated disclosure documents together with the sophistication of the public securities marketplace.

BDM believes that the marketplace for securities, such as that provided by the NYSE, is efficient and effective in accurately evaluating the value of a given company. We similarly believe that the marketplace likely values BDM stock on a different basis than that of a company with diversified ownership and exposure to takeover. Prospective investors may view well-managed companies like BDM more favorably if there is assured continuity of management.

It is sometimes argued that dual class capitalizations deprive shareholders of hidden wealth. We believe that one share, one vote may protect the franchise of shareholders, but at no real added value to their investment. This result is, at the least, something for investors to choose, and not for policymakers or self-regulating organizations to impose.

To deny to BDM's shareholders access to the public market provided by the NYSE, because of their decision to operate the Company as a continuing entity removed from the threat of a contest for control, would be an inappropriate exercise of listing standards. The NYSE should be free to grow and move with its customers - those companies whose shareholders have decided to favor companies like BDM over shares in the takeover market.

Earle C. Williams
President & CEO

CINCINNATI MILACRON
Cincinnati, Ohio
December 5, 1986

Milacron believes that in recent years short-term, speculative investors have exercised undue influence in the governance of many publicly traded companies. This has caused some companies to be overly concerned with short-term performance at the expense of the long-term best interests of such companies. Milacron has emphasized long-range planning and the dedication of the Company's resources to long-term goals since the founding of the Company over 100 years ago. It is believed that this philosophy is important to many shareholders and has been responsible for increasing the value of the Company's shares over the long-term despite the relatively cyclical nature of its business and changes in economic conditions. It is further believed that concentrating only on a short-term business philosophy could have an adverse long-term impact on the Company and its shareholders.

Milacron is particularly concerned about the growing influence on the management of public companies of investment managers interested in short-term portfolio performance rather than long-term growth and hence their support for highly leveraged takeovers or management strategies which emphasize only short-term return. It is therefore considered important to foster an atmosphere in which Directors of a company such as Milacron can make decisions which will be in the long-term best interests of the company and all of its shareholders. To this end, time phased or other limited disparate voting plans such as would be permitted under the Amended Voting Rights Listing Standards seek to give long-term holders a greater voice in the Company's affairs than short-term holders.

While such plans may discourage hostile takeovers, they put the Board of Directors in the best position to represent the interest of all shareholders.

If the shareholders by the vote required in these proposed Listing Standards agree that the plan would be beneficial to their company, it can be implemented without a need to delist from the New York Stock Exchange. Such plans may not be right for all companies, but they can be for some and directors and shareholders together should have the opportunity to decide on the benefits in their own particular circumstances.

James A. D. Geier
Chairman & CEO

THE COASTAL CORPORATION
Houston, Texas
December 4, 1986

The Coastal Corporation ("Coastal") supports the proposal of the New York Stock Exchange.

Coastal believes that the constitutionally protected property rights of its stockholders would be improperly interfered with by administrative limitations on voting rights of stockholders such as the imposition of a "one share-one vote" standard.

Coastal believes that if a company's Board of Directors determines in accordance with State law to submit voting rights provisions to stockholders for approval by a vote mandated by State law, the Federal government should not impose a "Federal Corporate Law" standard by requiring a vote of directors and stockholders which varies from the vote provided by State law.

Coastal is convinced that the Class A Common Stock continues to represent the vital best interests of all stockholders and has contributed to the significant increase in shareholder value since the stockholder vote for approval.

The NYSE proposal for a vote in excess of State law requirements tends to give institutional investors as a group veto power over approval of disparate voting rights stock. This relatively small number of stockholders with very substantial economic power would have the ability to frustrate the wishes of the larger group of individual holders on an issue in which their investment objectives may be opposed to those of the larger group. Increasing the power of institutions by requiring more than majority approval would further undermine the confidence of individuals in the market for equity securities.

Coastal is of the opinion that the State legislatures and the NYSE, respectively, should retain the right to determine requirements for corporations and listing of shares. Assumption of control over these requirements by the Commission would constitute an unprecedented, unwarranted and improper intrusion which has not been sanctioned by the United States Congress. The proper role for the Commission in matters of voting rights as with other matters affecting securities markets should continue to be the assurance of full disclosure.

James R. Paul
President

THE COMMITTEE OF PUBLICLY OWNED COMPANIES
New York, New York
November 5, 1986

There are many reasons why dual class capitalizations may be advantageous. They have been used to facilitate the successful absorption of an acquired company, as was done twice by General Motors. They have been used to protect the editorial independence of our great newspapers, such as The New York Times and Wall Street Journal. They have proven useful in attracting investors to purchase shares of small and medium-sized companies, whose weighted shares carry enhanced dividend rights. Their greater flexibility has been a boon to the shareowners of American Greetings, Hershey Foods, Wang Laboratories and many other corporations. Indeed, more than 200 companies traded on the Amex or over-the-counter have dual class stock.

As the markets become increasingly globalized, it would be ill-fitting if General Motors shares could be purchased on the London or Tokyo Stock Exchanges, but not on the New York Stock Exchange.

The Committee of Publicly Owned Companies, founded in 1973, is a nationwide organization of chief executive officers focusing on measures to widen the shareowner base and otherwise make it easier for companies of all sizes to raise equity capital.

Over 200 of our members have chosen to list their shares on the New York Stock Exchange. We respectfully urge the SEC to permit their shareowners continued access to the Exchange even in those instances in which they see fit to approve weighted-share voting arrangements.

B. M. Siegel
Executive Director

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* The Committee of Publicly Owned Commpanies represents 600 public corporations.

COOPER INDUSTRIES
Houston, Texas
November 24, 1986

After reading the New York Stock Exchange's proposed revision to its so-called "one share, one vote" policy as contained in SEC Release #34-23724, it is our view that this proposed revision should be approved.

Irrespective of the arguments on either side of the disparate vote issue, the New York Stock Exchange proposal is grounded firmly in the concept of "shareholder democracy" by establishing as prerequisites the approval of disparate rights voting stock by majorities both of independent directors and of independent shareholders.

We share the belief that companies and their shareholders should be free to choose the capital structure that suits them best and to also be free to trade their securities on whatever exchange is best for them. The New York Stock Exchange proposed revision moves in that direction.

Alan E. Riedel
Senior Vice President,
Administration

CULP, INC.
High Point, North Carolina
December 31, 1986

As a public company traded in the NASDAQ system (or over-the-counter), with no restrictions imposed on the voting rights of our shares, we believe that it is important that the Commission not take any action which would restrict companies such as ours to raise capital through the equity markets.

Circumstances can arise which make it prudent for a company such as ours to seek additional equity financing without diluting the voting strength of those entrusted to manage its affairs and plan its future growth. To be prevented from doing so by regulation, and being forced to seek other sources of capital could seriously impair a company's ability to compete.

If we offer a Class B Common Stock with different voting rights, investors must decide whether or not to purchase those shares. However, it is certainly possible that such an investment will satisfy the goals of certain investors.

We firmly believe that the market place should be allowed to control the securities a company issues, and sincerely hope that the Commission will not see the need to impose additional regulations on what is working well in the NASDAQ market as it currently exists.

Franklin N. Saxon
Vice President & Chief
Financial Officer

DETROIT EDISON
Detroit, Michigan
November 20, 1986

This letter is submitted in response to the proposed rule change by the New York Stock Exchange relating to amendments to the Exchange's voting rights listing standards for domestic companies.

We generally support the "one share, one vote policy." We recognize, however, that because of increased competition and the changes taking place in the investment and regulatory world, modifications to this policy should be made to accommodate stock with disparate voting rights. We have reviewed the proposed rule change and believe that the approval requirements for the disparate voting rights stock are appropriate under the circumstances.

Accordingly, we support the proposed rule change by the New York Stock Exchange.

Walter J. McCarthy, Jr.
Chairman of the Board

DOW JONES & COMPANY, INC.
New York, New York
December 2, 1986

Dow Jones urges the Commission to approve the proposed rule change. Dow Jones believes that there can be legitimate reasons for the shareholders of a listed company to conclude that their best interests will be served by adopting two classes of common stock with different voting rights.

In Dow Jones' case, the creation of a new class of common stock was motivated by our shareholders' desire to insure the journalistic independence and integrity of The Wall Street Journal and the Company's other publications and services into the next century.

Dow Jones' stockholders shared this view and expressed it in an overwhelmingly favorable vote; our minority shareholders alone voted 3-to-1 in favor. We think it would be unfortunate, after expressing their desires so clearly in this way, if shareholders then were penalized by having their company's stock delisted. This strikes us as the opposite of shareholder democracy.

It appears clear that important corporate goals can be served by common stocks with different voting rights as other companies, such as Hershey Foods, Coastal Corporation and General Motors, have also concluded. At the same time, we are not aware of any indication that the stockholders of public companies, or the markets for their securities, are adversely affected thereby. Both the New York Times and the Washington Post, for example, created two classes of common stock many years ago in order to preserve journalistic independence through the maintenance of corporate control. As far as we are aware, in neither case are the stockholders of those companies, or the markets for their securities adversely affected or impaired in any way. Yet under current rules the shares of these excellent companies are barred from the New York Stock Exchange. (Both the New York Times and the Washington Post are classes of common stock with different voting rights.) Similarly, Ford Motor Company has traded on the New York Stock Exchange since the 1950s and has for that entire period had outstanding common shares with different voting rights -- again, as far as we are aware, with no adverse implications.

While an inflexible, per se rule may have been appropriate when originally adopted by the Exchange, it is Dow Jones' view that, in today's environment of full and timely disclosure under the federal securities laws, on the one hand, and volatile contests for corporate control, on the other, the Commission should approve the proposed rule change to allow the stockholders of a listed company to determine how best to protect their own interests.

Warren H. Phillips
Chairman of the Board

ELECTRO BIOLOGY, INC.
Fairfield, New Jersey
December 23, 1986

As a public company traded in the NASDAQ system (or over-the-counter), with no restrictions imposed on the voting rights of our shares, we believe that it is important that the Commission not take any action which would restrict companies such as ours to raise capital through the equity markets.

Circumstances can arise which make it prudent for a company such as ours to seek additional equity financing without diluting the voting strength of those entrusted to manage its affairs and plan its future growth. To be prevented from doing so by regulation, and being forced to seek other sources of capital could seriously impair a company's ability to compete.

If we offer a Class B Common Stock with different voting rights, investors must decide whether or not to purchase those shares.

We firmly believe that the market place should be allowed to control the securities a company issues, and sincerely hope that the Commission will not see the need to impose additional regulations on what is working well in the NASDAQ market as it currently exists.

Richard H. Resiner
Vice President, Finance

FOREST CITY ENTERPRISES, INC.
Cleveland, Ohio
November 12, 1986

The modification of the current "one share one vote" rule to allow companies listed on The New York Stock Exchange to issue disparate voting rights stock is a favorable development. The creation of stock with preferential voting rights allows the interested and informed stockholders holding such stock to control long term corporate goals and management strategy. Business dealings are facilitated when it is known that interested stockholders are in control of the management and direction of a company and will remain in control. The issuance of stock with disparate voting rights is essential if companies are to retain the ability to determine their capital structure, long term goals, and corporate growth.

The typical outside investor is not harmed by the existence of disparate voting rights stock, as such investor is not as concerned with voting rights as with dividend potential and gain on investment. Full prior disclosure of the voting and participation rights of a class of stock enables potential investors to weigh their investment goals and interest and make informed investment decisions.

William M. Warren
Senior Vice President &
General Counsel

THE GAP, INC.
San Bruno, California
December 4, 1986

The Exchange should permit listed companies to issue a class or classes of common stock or other voting equity securities with disparate voting rights.

Dexter C. Tight
Senior Vice President &
General Counsel

HERSHEY FOODS CORPORATION
Hershey, Pennsylvania
December 1, 1986

Our dual class recapitalization plan has been described as the "equity expansion" program. This plan was adopted to enable Hershey to have available the additional common equity needed to finance our future growth and achieve our long-term strategic plan goals. Without a dual class structure, this opportunity would not have been possible. In our own case, our dual class capitalization plan has been in the best interests of stockholders and is consistent with the highest standards of fairness, corporate democracy and protection of stockholder rights.

The majority stockholder of Hershey's common stock is the Hershey Trust Company. The Hershey Trust had indicated that, while it did not want to constrain the Corporation's ability to grow, it was desirable for the Hershey Trust to maintain voting control so that it could discharge its fiduciary duty. The Hershey Trust noted that, as a fiduciary, it was acting to protect the interest of the sole beneficiary of the trust, Milton Hershey School.

Hershey Trust indicated to the Corporation that it believed the relationship that has existed -- and still exists -- among the School, the Corporation, and the model community designed by Milton S. Hershey, our common founder, was unique in American corporate history and that the continuance of this relationship was desirable for the fulfillment and protection of Mr. Hershey's philanthropic legacy . . . Thus, the situation that was presented was not that of an individual stockholder or group of stockholders initiating a plan to retain voting control for their own gain, but that of a non-profit school for children with a long-established history of helping the disadvantaged and a reputation for integrity seeking to protect and fulfill its charitable mission.

Hershey's circumstances are unquestionably unique and the dual class capital structure we adopted has been appropriate for us under these circumstances. The capital structure of other companies will, and should be, different as individual circumstances dictate. There are many factors that determine what capital structure is appropriate for any given company; for some it will be a single class of common stock and a class of non-voting preferred stock, for others it may be a dual class structure such as our own. The possibilities are so extensive that we believe that flexibility should be permitted and encouraged and that it is not appropriate for the Federal government to limit companies and their stockholders in determining what innovative capital and financial structures will best support their businesses in today's highly competitive markets.

We believe that the creation of a dual class structure can be in the best interest of all stockholders. In our own case, we believe that the substance of our equity expansion proposal and the manner in which it was adopted demonstrate adherence to the highest standards of fairness and corporate democracy. Hershey's stockholders have benefited from our commitment to growth and our ability with our equity expansion program to have our businesses continue to grow and expand.

Richard A. Zimmerman
Chairman & CEO

HERSHEY TRUST COMPANY
Harrisburg, Pennsylvania
December 4, 1986

Hershey Trust Company, in its capacity as trustee for the Milton Hershey School ("the School Trust"), holds voting control of Hershey Foods Corporation . . . The School Trust supports the proposed rule change.

Hershey Foods Corporation has been a NYSE listed company since it first went public in 1927, but the School Trust's voting control pre-dates that event . . . When Hershey Foods Corporation sold shares to the public in 1927, the School Trust's voting control continued. No stockholder who purchased or received shares of stock of Hershey Foods Corporation from the time it first became available to the public in 1927 to the present time did so with the expectation of being able to affect the outcome of any matter which as a matter of corporate law required the vote of a majority of the shares of outstanding stock.

The School Trust believes that the dual capitalization structure adopted by Hershey Foods Corporation's stockholders was in its best interest and in the best interest of the minority stockholders. No one was disenfranchised since the School Trust had the majority voting control of Hershey before the recapitalization and continues to have it following the recapitalization. The minority stockholders were protected procedurally by being fully informed and by being given the power to approve or disapprove the proposal as a class; they were protected substantively by being given additional dividend rights and by being given the power to elect one-sixth of the Board of Directors. All stockholders were benefited by the ability of the Company to achieve growth through stock acquisitions and to seek additional capital through the equity market should it choose to do so. The continued success of Hershey Foods Corporation, as reflected in the increase in its stock price, demonstrates that the market itself has viewed the recapitalization favorably.

We believe that the response, which created two classes of common stock with unequal voting rights, was in the best tradition of flexible and innovative corporate governance and should be encouraged. Certainly, where no disenfranchisement occurs, where additional voting rights are provided to the minority stockholders, where there is full disclosure and where the minority stockholders themselves approve the dual capitalization, no reasons exist for de-listing the Company's common stock.

Rod J. Pera, Esq.
McNees, Wallace & Nurick

JACOR
Cincinnati, Ohio
January 7, 1987

This is in reference to the hearings the Commission recently held on the request of the New York Stock Exchange to eliminate its one share/one vote requirement.

As a public company traded in the NASDAQ system (or over-the-counter), with no restrictions imposed on the voting rights of our shares, we believe that it is important that the Commission not take any action which would restrict companies such as ours to raise capital through the equity markets.

Circumstances can arise which make it prudent for a company such as ours to seek additional equity financing without diluting the voting strength of those entrusted to manage its affairs and plan its future growth. To be prevented from doing so by regulation, and being forced to seek other sources of capital could seriously impair a company's ability to compete.

If we offer a Class B Common Stock with different voting rights, investors must decide whether or not to purchase those shares. However, it is certainly possible that such an investment will satisfy the goals of certain investors.

We firmly believe that the market place should be allowed to control the securities a company issues, and sincerely hope that the Commission will not see the need to impose additional regulations on what is working well in the NASDAQ market as it currently exists.

Terry S. Jacobs
Chairman & CEO

NATIONAL ASSOCIATION OF MANUFACTURERS
Washington, D.C.
December 5, 1986

A substantial number of NAM member companies are publicly traded on the New York Stock Exchange and would be adversely affected by a restriction on the creation of new common stock classifications based on voting rights.

NAM believes that to dismiss the relevance and significance of state law on this matter is to cast aside the fundamentals which underlie our entrepreneurial system.

Every state in the nation prescribes basic chartering standards with respect to shareholder suffrage . . . Were there reason to believe a problem existed with the alleged disenfranchisement of shareholders, surely the states would have acted . . . To suggest a need for a single, uniform, federal "solution" is to fail to acknowledge that states function as corporate governance laboratories. This method allows for limiting the risks of evolutionary corporate practices to the advantage of the nation as a whole.

Absolute deference must be paid to the validity and continuing value of state law as it relates to the business judgment rule.

In the case of companies proposing to adopt dual class capitalization, shareholders are well protected by the vigilance of private action and judicial activism. Nothing has yet been demonstrated to reveal where shareholders have not had adequate protection in the area of dual capitalization. The fundamental public policy concerns of shareholder protection are reflected in state corporate statutes and are the responsibility of the courts to insure.

The fundamental right to vote is vastly different in the corporate setting. The Constitution guarantees the right to vote for the election of government officials. The Constitution also guarantees entrepreneurial independence which has been and continues to be the foundation of the U.S. free market system. Those who use the rhetoric of one share, one vote, are being led to believe that the corporate entity, as a matter of uniform national practice, must have a single institutional structure. This rhetoric misses the point, which is that a corporation is an economic, not a political institution; shareholders are investors, not corporate "citizens".

A uniform capital structure standard would remove the independence of corporate founders, directors, managers and shareholders to select the capital market in which they wish the company to compete. Moreover, it would deny the shareholders any investment choice, as many non-voting shares provide a premium to the investor.

There is a strong belief that the marketplace for securities is efficient and effective in accurately evaluating the value of a given company. Accordingly the marketplace will likely value stock of a company having disparate voting on a different basis from a company of diversified ownership and exposure to takeover.

Virtually no evidence exists to show that shareholders have in fact been disenfranchised by dual class capitalization. States closely regulate internal governance issues, without feeling constrained to reject dual class capitalization. This would lead one to believe that shareholders have sensed neither disenfranchisement nor other specters of unfairness.

While a purpose of a dual capital structure is to preserve control, there exists no public policy manifestation that hostile takeovers are in fact beneficial to our society or should be made easier to accomplish.

NAM firmly believes that the SEC should approve the New York Stock Exchange proposal for disparate voting rights stock. Such support will ultimately carry the business community and the investing public away from an attempt to provide for "cookie cutter" uniformity, with its greater risk to our system of free, innovative and evolutionary enterprise.

* The NAM is a voluntary business association of over 11,000 corporations, large and small, located in every state.

NORSK DATA A.S
Oslo, Noway
January 2, 1987

We are a Norwegian company. Norwegian law and Norwegian Government regulations limit ownership of the fully voting A shares by non-Norwegian nationals. Therefore, only the limited voting Class B shares are traded in the NASDAQ system.

Virtually all new equity for our company in recent years has been raised through the issue of B shares, to a large extent to American investors. These issues have been registered under the U.S. securities laws, offering U.S. and foreign investors the protection such registration entails.

New American restrictions on the issue of our limited-voting B shares might result in our not registering any such future issues under the U.S. securities laws.

In that event, non-U.S. investors would be deprived of the protection offered by SEC regulation of such share issues and U.S. investors would be deprived of the possibility to judge for themselves whether or not they should invest in such possible future issues of our class B shares.

We firmly believe that the marketplace should be allowed to control the securities a company issues, and sincerely hope that the Commission will not see the need to impose additional regulations on what is working well in the NASDAQ market as it currently exists.

Tharald Brovig
Vice Chairman

NORTEK, INC.
Providence, Rhode Island
December 1, 1986

I am of the belief that the economic motivation of insiders is to maximize the value of their share holdings in a company. Consequently, if a proposal is made by management of a company to create two classes of stock one should conclude that it is the belief of the insiders that, in the long term, the value of their holdings will increase.

To the extent that the proposed New York Stock Rules allow other shareholders, after approval by the independent directors, to express their opinion with regard to the benefit of disparate voting on their long term holdings and that all shareholders are treated equally, I can only see a long term benefit to all shareholders.

Since the American Stock Exchange listed companies and Over-The-Counter traded securities can have disparate voting, it would appear that the NYSE would be held at a competitive disadvantage if the proposed rule were not changed.

Bruce Fleming
Vice President -
Business Development

POTLATCH CORPORATION
San Francisco, California
November 25, 1986

The Company believes that in recent years short-term speculative investors have exercised undue influence in the governance of publicly traded companies. This has caused some companies to be overly concerned with short-term performance at the expense of the long-term best interests of such companies and their shareholders.

Potlatch Corporation is solely in the forest products business which is a cyclic industry. It takes many years to grow a tree and to receive a return on the heavy investment required for its harvest and conversion into wood and pulp-based products. Our Board of Directors and a majority of our stockholders share a commitment to a long-term view in the management of the Company's affairs even in the face of changing economic cycles within the industry. Thus, for many decades Potlatch has emphasized long-range planning and the dedication of the Company's resources to long-term goals.

"Time phased voting" gives such long-term committed stockholders a greater voice in the Company's affairs than short-term investors. A raider can gain immediate control of the Company by acquiring 81% of the stock whereas an investor can gain control by buying 51% of the stock and holding it for four years.

Greater flexibility must be permitted to the Exchange and to its member corporations to manage their affairs. At the same time, investor safeguards and continuing stockholder participation in the formulation of corporate policy must be maintained. We believe the proposed rule accomplishes both these ends. The investing public can assess the existence of such voting rights before electing to participate and can determine the extent to which a company's securities are attractive as an investment vehicle.

In closing, it is suggested that the proposed rule is premised upon a democratic corporate governance procedure whereby stockholders, operating in a changing world, may cast their votes for new strategies which may make their corporation more viable and innovative and not subject to the harassment of short-term speculators.

Richard B. Madden
Chairman & CEO

PRIME CAPITAL CORPORATION
Rolling Meadows, Illinois
January 6, 1987

We believe it is important that the Commission not take any action which would restrict companies such as ours to raise capital through the equity markets.

Circumstances can arise which make it prudent for a company such as ours to seek additional equity financing without diluting the voting strength of those entrusted to manage its affairs and plan its future growth. To be prevented from doing so by regulation, and being forced to seek other sources of capital could seriously impair a company's ability to compete.

If we offer a Class B Common Stock with different voting rights, investors must decide whether or not to purchase those shares. However, it is certainly possible that such an investment will satisfy the goals of certain investors.

We firmly believe that the marketplace should be allowed to control the securities a company issues, and sincerely hope that the Commission will not see the need to impose additional regulations on what is working well in the NASDAQ market.

James A. Friedman
President

THE J. M. SMUCKER COMPANY
Orrville, Ohio
December 1, 1986

In the almost 90 years of its existence, our Company has operated in accordance with what we term our Basic Beliefs. These include, among other things, fair treatment of our shareholders, employees, customers, and suppliers; integrity of management; the manufacture of only the highest quality products; and long-term growth to achieve the full potential of our Company and provide a fair return to our shareholders on their investment.

Our decision to recommend to our shareholders the adoption of a time-phase voting structure for our shares was an affirmation of those Basic Beliefs.

Some critics have maintained that disparate voting has a chilling effect on an issuer's stock values. Our experience does not substantiate that assertion. Since our shareholders adopted disparate voting, the market price of our stock has increased approximately twenty percent.

While we believe that the NYSE's proposed rule is entirely consistent with "shareholder democracy," we also believe that to analogize shareholder democracy to political democracy is to create a false issue. Voting is only one element of the contractual rights that comprise a publicly held company. Most corporate constituents, including many preferred shareholders, bondholders, suppliers, customers, and employees have no vote at all even though they invest in the company or otherwise have a very direct interest in its operations. It seems to us clear that government should not place restrictions on the ability of investors to structure their investment entities as they deem appropriate unless there are very good, substantive reasons for doing so. We see no such reasons here. Indeed, it is, we think extremely unlikely that a bona fide investor is going to refrain from buying stock in a company that is well-managed, offers good and legitimate products and services, and offers a good return on investment merely because that company's contractual makeup includes disparate voting rights.

We, therefore, urge the Securities and Exchange Commission to approve the NYSE's proposed rule in its present form. It is not inimical to the concept of "shareholder democracy," it allows for full application of shareholder voting rights in order to establish disparate voting in the first place, and we believe that its approval is fully consistent with the needs and rights of the investing public.

Paul Smucker
Chairman

DOW JONES & COMPANY, INC.
200 Liberty Street · New York, N.Y. 10281

RAY SHAW
PRESIDENT

March 15, 1988

The Honorable William Proxmire
Chairman, Senate Banking Committee
SD 546
Washington, DC 20510

Disparate Voting Rights

Dear Senator Proxmire:

We understand that the Senate Banking Committee plans to hold hearings on March 17 on the issue of restricting the ability of public companies to issue classes of common stock with disparate voting rights.

In that connection I am enclosing for the Committee's consideration a copy of the statement that Dow Jones gave to the Securities and Exchange Commission in connection with The New York Stock Exchange's proposal to permit the issuance of such stock. Although I understand that the Committee's hearings will focus on the more general topic of "one-share, one vote", I believe that the views set forth in this statement are relevant to the Committee's inquiries.

Dow Jones believes that there can be legitimate reasons for the stockholders of a public company to conclude that their best interests will be served by adopting two classes of common stock with different voting rights.

In Dow Jones' case, the creation of a new class of common stock was motivated by our stockholders' desire to insure the journalistic independence and integrity of The Wall Street Journal and the Company's other publications and services into the next century. As a result, we firmly believe that Dow Jones' prospects for continued financial success will be improved to the substantial benefit of all our stockholders.

Dow Jones' stockholders shared this view and expressed it in an overwhelmingly favorable vote; our minority shareholders alone voted 3-to-1 in favor. It strikes us as the opposite of stockholder democracy to declare this conclusion illegitimate.

We appreciate the opportunity to give the Committee our views on this important issue.

Very truly yours,

Ray Shaw

STATEMENT OF DOW JONES & COMPANY, INC. IN SUPPORT OF PROPOSED RULE CHANGE BY THE NEW YORK STOCK EXCHANGE, INC. RELATING TO THE EXCHANGE'S VOTING RIGHTS LISTING STANDARDS

This statement is submitted by Dow Jones & Company, Inc. in response to the solicitation of written comments by the Securities and Exchange Commission regarding the proposed rule change by the New York State Exchange, Inc. relating to the Exchange's voting rights listing standards.

As discussed more fully below, Dow Jones urges the Commission to approve the proposed rule change in order to allow the continued listing of shares in a company with two or more classes of common stock with different voting rights, subject to the conditions contained in the proposed rule.

Dow Jones firmly believes that, while there may be merit to the general proposition that voting power should be shared by stockholders in proportion to their relative equity interests, there can be legitimate countervailing considerations that outweigh that general proposition in appropriate circumstances. It is our view that the Exchange's concern for the welfare of a listed company's stockholders would be completely satisfied if those stockholders themselves decide, after being fully apprised of all the relevant facts, that they are better protected by a capital structure which permits the separation of voting power from relative equity interests.

We understand that the Commission is soliciting views from a diverse range of parties with an interest in the proposed rule change. Accordingly, we will confine our comments regarding the proposed rule change largely to a discussion of the purpose of the recent distribution by Dow Jones of a second class of stock having different voting rights from its common stock.

The Dow Jones Class B Stock Distribution

At their Annual Meeting in April 1984, Dow Jones' stockholders approved the creation of a new class B stock and its distribution to all of the Company's stockholders on the basis of one share of class B for every two shares of existing common stock.*

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* Implementation of the class B stock distribution was delayed until June 1986, when a minority stockholders' suit challenging the proposal was resolved.

The class B stock proposal was fully, indeed exhaustively, described in the Company's proxy statement for the Annual Meeting. (Copies of our proxy statement are enclosed for the convenience of the Commission.) As described there, the class B stock has ten votes per share and is transferable only to a stockholder's family members or certain of a stockholder's affiliates. The class B stock is, however, freely convertible on a share-for-share basis into common stock. The Company's common stock continues to have one vote per share and continues to be publicly traded. In addition, the common stock has the right, voting as a class, to elect one-third of the Company's directors. At such time as the number of outstanding class B shares falls below 12,000,000, the class B stock will automatically convert into common stock and will thus cease to be outstanding.

Because of the significant restrictions on the transferability of the class B shares, it is expected that stockholders desiring to sell their holdings in the Company will, over time, convert their class B shares into shares of common stock. As such conversions occur, the converted class B shares, with ten votes per share, will be replaced by shares of common stock carrying only one vote per share. Accordingly, stockholders who continue to hold class B shares will, by virtue of the reduction of the number of outstanding class B shares and the consequent reduction in the total number of votes, realize an automatic increase in their relative voting power.

It is anticipated that Dow Jones' majority stockholders, members of the Bancroft family and trusts and charitable organizations which they have established, will retain their shares of class B stock to the extent possible. As a result, it is anticipated that the voting control of the Company by the Bancroft family will be maintained over time.

The vote was overwhelmingly in favor of the class B stock proposal. With over 91% of the Company's 64,135,501 shares represented at the meeting, the stockholders of the Company, other than members of the Bancroft family, voted better than 3 to 1 in favor of the proposal. Although exact information is impossible to obtain, the available data indicate that our institutional stockholders also voted over 3 to 1 in favor.**

** The vote, excluding the Bancroft family's shares, was 16,030,323 (71.4%) in favor, 5,260,632 (23.4%) against, and 1,146,286 (5.1%) abstained.

The vote, including the Bancroft family's shares, was 52,066,204 (89.0%) in favor, 5,260,632 (9.0%) against, and 1,146,286 (2.0%) abstained.

We have included these statistics to show that stockholders, when presented with this kind of proposal under appropriate circumstances, and, as described below, for a purpose directly related to the fortunes of their company, may well find it in their best interests to separate voting power from relative equity interests. The Exchange's current per se rule against separating voting power from equity interests in such a case could cause some stockholders to believe that the Exchange is penalizing them -- by forcing their company off the Exchange -- for choosing a perfectly proper course of action.

The Purpose of the Class B Stock Distribution

The purpose of the class B stock distribution is to insure the independence and integrity of The Wall Street Journal and the Company's other publications and services into the next century by facilitating continued control of the Company by the Bancroft family. We firmly believe that, as a result, the Company's prospects for continued financial success will be improved to the substantial benefit of all out stockholders.

Ever since Dow Jones was acquired by Clarence Barron in 1902, the Company and its Board of Directors have zealously and vigorously defended the editorial independence and integrity of The Wall Street Journal and the Company's other publications and services, including Barron's and the Dow Jones News Service (commonly known as the "ticker" or the "broad tape"). Dow Jones believes that in the long run its reputation for forthrightness, candor, integrity and independence is the most important prerequisite for continued financial success. If that reputation were threatened or compromised, neither The Wall Street Journal nor any of the other Dow Jones publications or services would command the respect and following they have achieved over the years.

Since 1902 the Company's independence from outside financial influence has been protected by concentration of ownership of its shares, first in the hands of Mr. Barron, and then in the hands of his late stepdaughter Jane W. W. Bancroft and her descendants. The members of the Bancroft family (and trusts and charitable organizations which they have established) now own approximately 55% of the Company's common stock and class B common stock. For more than 80 years the Bancroft family members have emphasized the importance of aggressive, independent and fearless journalism, and have respected absolutely the editorial independence of The Wall Street Journal and the other Dow Jones publications and services.

Since the Bancroft family in 1984 controlled more than half of the Company's outstanding shares, Dow Jones' journalistic independence and integrity were not threatened at that time. Nor was there likely to be any threat to that independence in the foreseeable future. The management of Dow Jones and its Board of Directors concluded, however, that the Company should make plans to preserve its independence and integrity into the twenty-first century. With solely that goal in mind, the Board of Directors -- including all seven independent, disinterested directors -- considered and unanimously approved the class B stock distribution.

The distribution of the class B stock by design could not have any immediate effect on the status quo, nor could it limit or restrict the rights of any current stockholders. Since the class B shares were distributed on a strict pro rata basis, the relative voting power of all present stockholders, without exception, remained the same. The voting power of the Bancroft family could not be increased, nor could it ever be increased, relative to any other stockholders of the Company unless and until such stockholders choose to sell of some of their holdings. Even then the voting power of the Bancroft family will increase relative to that of other current stockholders only to the extent that such stockholders sell a larger proportion of their shares than the Bancroft family may sell of theirs.

Accordingly, those stockholders holding class B common stock with a long-term interest in the Company who do not sell their holdings will benefit equally in a proportionate increase in their voting power. On the other hand, those stockholders who sell their shares will, as is always the case, lose the right to vote therefore, contribute to insuring that the journalistic independence and integrity of the Company are protected by those stockholders who have a long-term interest in the Company.

The Exchange's Listing Policies

We believe that the Exchange should continue to impose high standards upon its listed companies in order to maintain its well-earned reputation for excellence.

We do not believe, however, that it is consistent with the Exchange's leadership or with the interests of the stockholders of its listed companies to continue to impose a per se rule against classes of common stock with different voting rights. As I hope the foregoing description of Dow Jones' case illustrates, there can be legitimate concerns leading to the conclusion that all of the stockholders of a listed company are in fact better served by adopting two classes of common stock with different voting rights in order to insure the long-term success of their company. It is our view that, in such cases, where the stockholders of a listed company, after having been informed of all the relevant facts, determine that it is in their best interests to adopt such a plan, the Exchange does not further its own interests by requiring the company's shares to be delisted. And it should not -- in the name of protecting those stockholders -- force their company to leave the Exchange.

It appears clear, therefore, that important (and indeed prudent) corporate goals can be served by common stocks with different voting rights as other companies, such as Hershey Foods, Coastal Corporation and General Motors, have also concluded. At the same time, we are not aware of any indication that the stockholders of public companies, or the markets for their securities, are adversely affected thereby. Both the New York Times and the Washington Post, for example, created two classes of common stock many years ago in order to preserve journalistic independence through the maintenance of corporate control. As far as we are aware, in neither case are the stockholders of those companies, or the markets for their securities, adversely affected or impaired in any way. Yet under current rules the shares of these excellent companies are barred from the New York Stock Exchange. (Both the New York Times and the Washington Post are classes of common stock with different voting rights.) Similarly, Ford Motor Company has traded on the New York Stock Exchange since the 1950s and has for that entire period had outstanding common shares with different voting rights -- again, as far as we are aware, with no adverse implications.

While an inflexible, per se rule may have been appropriate when originally adopted by the Exchange, it is Dow Jones' view that, in today's environment of full and timely disclosure under the federal securities laws, on the one hand, and volatile contests for corporate control, on the other, the Commission should approve the proposed rule change to allow the stockholders of a listed company to determine how best to protect their own interests.

THE NEW YORK TIMES COMPANY
229 WEST 43 STREET
NEW YORK, N.Y. 10036

B. WATSON IV
CRETARY

(212) 556

March 16, 1988

BY HAND

Honorable William Proxmire
Chairman
Senate Banking Committee
Room 534
Dirksen Senate Office Building
Washington, DC 20510

RE: Dual Class Stock

Dear Senator Proxmire:

This letter is submitted by The New York Times Company (the "Company") in connection with the hearings scheduled for March 17, 1988, by the Senate Banking Committee on the issue of common stock with disparate voting rights.

Preliminarily, the Company notes that many commentators have addressed the general merits of dual class capitalization as well as the question of federal vs. state regulation. Because of the unique position of the Company, this letter will express no opinion on these general considerations and instead suggests, for the reasons set forth below, that if Congress determines to take action to restrict the ability of issuers to adopt and/or maintain dual class structures, the Company, and the few other similarly situated issuers, should be permanently excluded from the application of such legislation.

The Company is a diversified communications company incorporated under the laws of the State of New York in 1896. Among its other operations, it publishes The New York Times newspaper. The Company's Class A Common Stock is registered with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934, as amended, and is traded on the American Stock Exchange. As of March 1, 1988, 81,301,139 shares of Class A Common Stock were issued and outstanding and owned of record by approximately 14,940 shareholders. The Company's Class B Common Stock is not publicly traded. As of March 1, 1988, 444,383 shares of Class B Common Stock were issued and outstanding and owned of record by approximately 68 shareholders.

The Class A shares have limited voting rights, which include the right to vote as a separate class for the election of 30% of the Company's Board of Directors and to vote with the Class B shareholders on the reservation of shares for employee stock options, certain acquisitions and the ratification of the selection of independent accountants to serve as auditors of the Company. The Class B shares, which are primarily held by the descendants of Adolph S. Ochs, elect 70% of the Board of Directors of the Company and otherwise have unlimited voting rights. The shares of Class B stock are convertible into shares of Class A stock on a share-for-share basis at the option of the holder. Each share of Class A stock and Class B stock has one vote on each matter on which they vote.

Control of the Company has been in the family of Adolph S. Ochs since the turn of the century. It was his view, and it continues to be the view of present management, that control over the Company carries a responsibility to perpetuate The New York Times newspaper as an institution dedicated to the public interest and to maintain its editorial independence and integrity. The Company instituted its existing dual class capital structure prior to becoming a public company in order to insure that these objectives are and will continue to be met. The limited voting rights of the Class A stock were fully disclosed prior to public participation in the ownership of the Company.

It is well established that the overriding purpose of the Federal securities laws is to provide full disclosure of all material information to the investing public. Since such disclosure relating to the Class A stock was provided prior to its initial public offering, the Company believes that it is fair to conclude that all investors in Class A stock have taken into account the limited voting rights of such shares in making their investment decision to participate in the ownership of the Company. We note that unlike some issuers, the Company's capital structure was not adopted by "changing the rules of the game" and reducing or otherwise restricting existing rights of public shareholders. Moreover, we also note that a dual class capital structure is explicitly authorized by the New York Business Corporation Law. It has been, therefore, on the basis of both the prior knowledge of its public shareholders and the explicit sanction of New York law, that the Company adopted many years ago and continues to maintain its dual class capital structure. It is also in reliance on the validity of this structure that the Company has made plans and committed resources in order to preserve in the future the standards of editorial independence and integrity to which the Company has adhered for many years.

From a broader perspective, communications companies and, particularly, newspaper companies, require editorial independence to be successful. The experience of the industry clearly shows that the most successful of such companies are controlled by either a family or a core of individuals with an enduring commitment to this principle. At the same time, the financial resources required to make a modern communications enterprise competitive have today become far more than any such family or group can provide. In accommodating participation by the public in its ownership, the Company has attempted to balance the legitimate desire of its public shareholders for a voice in the management of the Company with the need to preserve the independence of the Company's communications operations and to shield these operations from detrimental disruptions. We believe the Company has been successful in addressing both these concerns. In the case of The New York Times newspaper, the continuing commitment for almost a century to the ideals of editorial independence and integrity has enabled the Company to attract and retain what we believe is one of the world's leading reportorial and editorial staffs. With regard to our public shareholders, as noted above, 30% of the Directors of the Company are elected solely by the Class A shareholders. Over the years, the individuals who have held and who now hold these directorships are a most distinguished group, whose views carry great weight in the management of the Company.

The Company believes that its financial history demonstrates that its dual class capital structure has not been detrimental to its public shareholders but has in fact promoted the long-term growth and financial success of the Company. The financial results of the Company, over the period it has been a public company, support this conclusion.

Consequently, we conclude that if the Committee determines to introduce legislation to restrict or eliminate dual class capital structures, the Company and similarly situated issuers who adopted such a structure with full disclosure prior to becoming a public company, should be entitled to a "grandfathered" exclusion from such rules.

Imposition of such legislation on the Company would have the effect of overriding not only the judgment of the Legislature of the State of New York, but also the informed investment decision of every one of the Company's Class A shareholders. Moreover, to limit the ability of newspaper companies to operate in this manner, based on a general theory of "corporate democracy" that may or may not be advisable for other types of issuers, we believe, would be detrimental to our public shareholders, our employees and the communities we serve.

The Company appreciates this opportunity to provide the Committee with our views on the issues raised by the proposed legislation relating to dual class capital structures.

Respectfully submitted,

Solomon B Watson, IV
Solomon B. Watson, IV

/cjf

April, 1988

POSITION PAPER OF MEDIA GENERAL, INC.

WITH RESPECT TO ONE SHARE/ONE VOTE

A restriction on the use of disproportionate voting stock would have an unfair and severely detrimental effect on Media General and other similar issuers.

Media General has two classes of outstanding stock, Class A Common Stock and Class B Common Stock. The Class A stock was first sold to the public in the late 1960's in a registered offering which fully described the voting rights of the two classes of common stock, and has been continuously listed on the American Stock Exchange since that time. The Class A stock elects 30% of the directors of Media General and, so long as it remains listed on an exchange, votes together with the Class B stock as a single class to authorize employee stock options and to authorize any corporate acquisition in which an officer or director has an interest or which involves a significant increase in the outstanding shares of either Class A or Class B stock. In addition, the holders of Class A stock are entitled under Virginia corporate law to vote as a separate class to approve amendments to the corporate charter, mergers, or similar matters affecting the Class A stock. The Class B stock elects the remaining 70% of the directors and votes on all other stockholder matters.

A one share/one vote requirement would prohibit the public trading of stock of an issuer if the voting rights of all of its voting securities are not uniform. This prohibition would apply regardless of the nature of the differences in voting rights, the time at which they were adopted, or the disclosure made at the time that stock was sold to the investing public. Such a broad prohibition is far more stringent than is necessary to deal effectively with tender offer related abuses and does not accommodate the beneficial policies served by some disproportionate voting stocks.

The Securities and Exchange Commission is presently engaged in a rulemaking which hopefully will result in uniform rules which will prohibit the trading of new classes of stocks with abusive limitations on voting rights.

Media General is strongly of the view that these efforts of the SEC should be allowed to continue. The use of disproportionate voting rights is not a single, uniform phenomenon. A study performed for the NASD by Professor Daniel R. Fischel of the University of Chicago concluded that dual classes of voting common stock can, in appropriate cases, fulfill necessary business and economic functions. Other disproportionate voting stocks, such as those which lose some or all of their voting power if transferred, may be unfair and detrimental to stockholders. Flexible rulemaking by the SEC or the securities self-regulatory agencies can deal more effectively and fairly with the variety of voting structures now in use or which may be developed in the future than can legislation.

If, however, legislation on this subject is considered necessary, Media General believes that trading restrictions should not apply to any class of stock which had been publicly traded prior to the introduction of legislation, particularly where any limitations on voting rights had been disclosed in a registration statement filed under the Securities Act of 1933.

To be meaningful, the exemption must also apply to additional shares of the same class which are issued after the grandfathering date in order to accommodate stock options, other stock related employee benefit plans, and future acquisitions or financing using publicly traded common stock. The exemption should also be unaffected by whether the class of stock continues to be traded in the particular market in which it traded on the grandfathering date. In addition, the exemption must be permanent. Suggestions that a universal one share/one vote rule could be phased in over a number of years are illusory and untenable because a delay in implementing such a rule does nothing to change the undesirable effects the rule will have when it is implemented, and there is nothing an issuer could do in the meantime to ameliorate those effects.

We believe that such a grandfathering provision, as it would apply to Media General, is justified by the following considerations:

1. **News publishers such as Media General and others are imbued with a public interest in its editorial integrity and independence.** This public interest is substantially protected by the dual class capital structures used by many of these corporations, which results in these corporations being controlled by, and accountable to, individuals with a tradition of journalistic independence and support. The potential threat to the news media resulting from hostile corporate takeovers is widely recognized, and is the subject of current Congressional investigation.

2. **The public stockholders have never been led to expect full voting rights, and have never paid for such rights.** The registration statement for each public offering of Media General Class A stock has disclosed the limited voting rights of the Class A stock, as have Media General's annual proxy material and other public filings. If the investing public discounts stock with less than full voting rights, the price received by Media General for its Class A stock would have reflected this discount. To give those full voting rights to the Class A stock now would be an unwarranted windfall to the present holders of that stock.

3. **A grant of full voting rights to the public stockholders would be unfair, and would do irreparable harm to the Company and the holders of the Class B stock.** The desire of the controlling stockholders of Media General to protect the corporation's journalistic independence and integrity by retaining the rights to elect a majority of the directors of Media General was an important, integral part of the decision to sell shares to the public. If the use of dual class capitalization had not been permitted at that time, management would have considered alternative methods for protecting that control, including the possi-

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March 16, 1988

Chairman William Proxmire
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen
Washington, D.C. 20510

Dear Chairman Proxmire,

I am delighted to hear that you are holding hearings on one share, one vote, and would like to submit these comments for the record. I note, however, that these comments represent my own views, and not necessarily those of the faculty or administration of the Benjamin N. Cardozo School of Law.

In the fall of 1986, the New York Stock Exchange (NYSE) submitted a proposal to the Securities and Exchange Commission (SEC), asking for permission to rescind its one-share, one vote rule. They were required to do so because the NYSE operates as a self-regulatory organization. It acts under the supervision of the SEC, issuing rules that, in other industries, are promulgated only by government agencies, under the requirements of the dministrative Procedures Act. The one share, one vote rule, has been in place for more than 60 years, as a federal standard, under the jurisdiction of the SEC. It provided that stock issued by companies listed with the NYSE must have equal voting rights. The NYSE submitted its proposal despite its own finding that the one share, one vote rule is "good for its listed companies, good for their shareholders, and good for this country...has served the market well, (and)...(i)n an ideal world, most people would probably want it to be retained."[1] But the NYSE found that it could no longer be the sole standard-bearer, as major companies threatened defection to the other exchanges, unless the rule was rescinded.

The justification for a one share, one vote rule goes to the heart of the concept of the corporation as a contract between parties who supply financial capital and those who supply human capital. Shareholders have two methods of assuring that the company's directors are satisfactory. They can provide overall direction by voting their shares. If they are unable to obtain satisfaction with the company's performance, they can sell their shares. Both are critical tools for making our publicly held companies as productive and competitive as possible.

The longer term consequences of a system in which managers have interests which diverge from those of the owners as a class are devastating. Available empirical evidence on dual capitalization is scant but troubling. The shares of those corporations which offer limited voting power compared to equity at risk have a lower trading value than those with one vote per share. Of the approximately 50 corporations that have recapitalized so as to change voting rights over the past five years, all but a handful have transferred voting control of the corporations permanently into the hands of existing management.

A study of the first twelve NYSE firms to institute recapitalization, done by the SEC's chief economist, shows devastating shareholder losses, averaging over 10% of total market value. Other evidence, examining dual-voting changes for AMEX and OTC firms, suggests a less dramatic effect. However, these are primarily firms in which management already exercised unusual control, prior to the institution of a dual voting plan, primarily because of the predominance on the NASDAQ of smaller, family- or founder-controlled companies. One would hardly expect to find as large a change in share value in these cases, in which insider control already existed, as occurs when recapitalizations are employed by large NYSE corporations to wrest control away from shareholders. The empirical data thus suggest that when dual capitalization is used to transfer voting control of corporations away from shareholders permanently into the hands of existing management, the result is inefficient.

As an economic matter, one share, one vote assures an identity of interests between those whose capital is at stake and those who direct the company, and that assures efficient, innovative, productive operations. The question, then, is when it must be imposed by statue. The Committee should clearly define the costs and benefits of dual capitalization in its various forms, to determine which are harmful and which are merely innovations in the structure of the capital market and share ownership.

I do not believe that the law should require one share, one vote for every company. As noted in your December 17 report, many companies with dual classes of stock perform very respectably.

What must be controlled by federal law is the method in which dual class stock is presented to shareholders. There is one method that is fair, and that is issuing stock with lesser voting shares, putting it on the market, and seeing what price it will bring. But it is absolutely unfair--in the economists' term, coercive--to allow dual class stock to be presented to shareholders in an exchange offer. There is no way to make that offer a fair one, which is what makes it so attractive to management.

The NYSE's one share, one vote rule has been in place for more than 60 years. There is only one reason for the pressure to rescind it, and that is the increase in hostile takeovers, and management's search for a cheap and easy way to stop them. In a takeover, someone outside the company sees that the stock is trading for less than its inherent value, so he offers shareholders more than the trading price. Takeovers are a way of putting value back into the economic system, and they are very beneficial to shareholders. A recent SEC study reported that takeovers between 1981 and 1986 have added $184 billion to the economy.[2]

Dual class stock prevents shareholders from taking advantage of takeover premiums. It prevents shareholders from objecting to other management-entrenching--and enriching--devices, like golden parachutes. Frankly, I think non-voting stock is a poor investment. But I believe in the market. If companies want to sell pizza-flavored toothpaste, let them put it on the shelf and see if anyone will buy it. The same goes for limited voting shares. Let it be put on the market in a public offering, and you will be able to see the value of the vote when you compare it to the trading price for the voting shares. You will see more companies like Resorts International, where the premium for the voting shares has been considerable.

But management does not want to offer those shares on the market--for just that reason. The comments of Senators Sasser, Sanford, and Chafee in the December 17 report are filled with support for shareholders being allowed to determine for themselves what they want for a particular company, and I endorse that policy completely. But because of a mathematical formula that is referred to as "The Prisoner's Dilemma," it is exchange offers--not a federally mandated one share, one vote rule--that seize that power from the shareholders. In exchange offers, individual shareholders are offered something which benefits each of them slightly as individuals, but hurts all of them as a group. It is prohibitively expensive to identify and work with other shareholders. In fact, given the poor records that are available on share ownership, it may be just plain prohibitive as a practical matter as well.

Just like a two-tier tender offer, exchange offers are coercive. It's like offering Allaedin new lamps for old, without revealing that it is the genie in the old lamp that makes it valuable. In this case, the genie is the vote. Putting this issue to individual shareholders is troubling enough. Putting it to institutional shareholders is worse, as their unclear and unenforced obligation as fiduciaries is met by a clear motivation to accommodate present and potential corporate clients. The outcome is certain to be economic harm to the beneficial owners.

The empirical evidence demonstrates the magnitude of this impediment. One particularly prominent study, conducted by the SEC's Office of the Chief Economist, has shown that two of the most popular types of antitakeover amendments approved by shareholders significantly reduce shareholder wealth. Testimony before the Senate on this issue included several examples of votes against financial interest in companies with large holdings by institutional investors, and even examples of conflicts of interest. Another study by the Yale Investor Behavior Project documents a systematic tendency for some types of investors to vote disproportionately often against dissidents in important proxy contests, also arguably a violation of fiduciary duty. In proxy contests, which represent the most direct challenges to existing management that occur within the voting system, institutional investors and large block-holders vote more consistently in favor of management than do any other classes of shareholders. The higher the level of institutional ownership, and the higher the level of block ownership in target firms, the less chance the dissident has to win the proxy contest.

Empirical evidence on the efficiency of the voting process that can shed some light on whether shareholders are capable of efficiently judging dual-class recapitalizations, has been virtually nonexistent. There has been a great deal of casual, or anecdotal evidence that the proxy process is fraught with inefficiencies and expense. But systematic evidence that shareholder interests--and more importantly, economic interests-

-are not being served by the process has not been developed.

Institutional investors do not vote efficiently because under current regulations, they are subject to considerable conflict-of-interest pressures. Because institutions may have ongoing business relationships with management, it does not pay institutional managers to oppose the wishes of the corporate board. If this is so, violations of fiduciary responsibility are likely to occur regularly in voting.

This constitutes the first methodical, statistical evidence that has been brought to bear to show systematic voting behavior by institutions. It shows that institutions do not generally increase the ability to oppose management, but rather that their behavior is consistently management-favoring. At the very least, these results raise serious questions about the efficiency of voting in reflecting shareholders' true fiduciary interests, and thus support the idea that it is too early to approve the NYSE rule, particularly given the Exchange's emphasis on the importance of institutional investors in ensuring efficient shareholder choice.

Other results in the tests also confirm the existence of structural inefficiencies and expense in the proxy voting system. In particular, the amount of time available for solicitation of votes, and the dispersion of the shareholder pool, both affect outcomes. The larger the shareholder pool, the less chance a dissident has of winning; while the longer the solicitation period, the greater are dissident chances. These results once again suggest that voting may reflect primarily strategic and structural, rather than economic considerations, and thus that the voting process should not at the current time be relied upon to permanently determine who has the right to vote in the corporation.

This evidence of the inability of the current system to reflect shareholder's financial interests contributes to the increasingly vocal tide of investor dissatisfaction with the ability to police managerial activities effectively through voting. If the voting process does not accurately reflect voter interest, than we cannot allow it to be used to relinquish the right to vote irrevocably.

We support actions to free the market from unjustified restraint.

Our concern here is that rescinding the one share, one vote rule will produce skewed results, reflecting and even exacerbating the weakness of the voting mechanism.

The one share, one vote rule cannot be abandoned without careful consideration of the various kinds of dual capitalizations and the various ways they are obtained. We cannot support this change as long as the current system for corporate governance impedes the ability of shareholders to make a responsible choice on the dual capitalization options that will be presented to them.

While we do not endorse limited voting stock, we recognize that it may present a worthwhile option for shareholders and management, and it should be made available to them. It can be done in a way that addresses the concerns of Senators Sasser, Sanford and Chafee about democracy and flexible methods for corporate financing. That way is to follow the model of the SEC proposal, and require limited voting stock to be presented to the market, instead of presented through exchange offers. We share your concerns, too, about federal pre-emption of matters traditionally left to the states. But one share, one vote has traditionally been an NYSE listing standard, imposed at the federal level through the SEC's approval of standards issued by a self-regulatory organization. The CTS v. Dynamics decision no calls into question whether that standard can continue at the federal level without explicit statutory language. For that reason, this serious problem can be addressed nowhere else but in Congress.

Shareholders receive most of the gains and incur most of the costs from business decisions; they therefore have the appropriate incentives to make choices about the overall direction of the corporation, including changes in the voting structure. But dual-voting recapitalization poses unusual, and, most important, irremediable harm. Once the vote has been relinquished, shareholders cannot change their minds. One thoughtful commentator referred to a dual class exchange offer as "a hostile takeover from the inside." I urge you to make this playing field level by making sure that shareholders can exercise their judgement, can make corporate democracy work, by prohibiting coercive exchange offers.

Sincerely,

Nell Minow
Executive Director
The Samuel and Ronnie Heyman Center on Corporate Governance

1. Testimony of the New York Stock Exchange to the Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce, United States House of Representatives, May 22, 1985; see also testimony before the Securities Subcommittee of the Committee on Banking, Housing and Urban Affairs, United States Senate, June 12, 1985), and statement by G. Keith Funston, President of the NYSE in 1957: "If the mass of our people are to risk their dollars on the nation's growth, there is no moral justification in depriving any shareholder in any publicly-held business of a corporate vote."

Apparently, even in the real world, most people want it to be retained. Careful reading of the NYSE's submission to the SEC shows that the 86 percent favorable rating it cites for listed companies is only the percentage of those responding who were in favor of changing the rule. In fact, only 13 percent of the 3224 Exchange constituents and other interested parties surveyed on this issue responded at all, suggesting little interest in changing the rule. Only 249 (less than 8 percent) of all of those surveyed responded in favor of the change. (Submission of the NYSE, File No. SR-NYSE 86-17, Exhibit B.)

2. See "Stock Market Profits from Takeover Activity Between 1981 and 1986," By Commissioner Joseph A. Grundfest and Bernard S. Black, September 28, 1987 That paper cites Professor Michael Jensen's finding that takeovers may have increased shareholder wealth by $400 billion (in current dollars) between 1977 and 1986.

idelity Investments

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March 17, 1988

Senator William Proxmire, Chairman
Senate Committee on Banking,
Housing and Urban Affairs
Senate Dirksen Building, Room 534
Washington D.C. 20510

Dear Mr. Chairman:

We understand that your committee is considering the need for legislation which would establish a uniform "one share, one vote" standard for stocks traded in major American markets. We are writing to you to express our strong support for that standard.

Fidelity Investments is a financial services company which manages assets of approximately $80 billion. Most of those assets are owned by mutual funds, which together constitute one of the largest holders of equity securities issued by U.S. companies. Accordingly, we have a strong interest in effective corporate democracy.

We see the fundamental issue in the "one share, one vote" debate as one of management accountability. Shareholders are the owners of their companies, and as such should have ultimate control over their companies' actions. We believe that accountability to shareholders is essential to ensure the long-term well-being of American corporations.

The mechanism of corporate suffrage is necessary to ensure management accountability. The only practical check on management is the power of the shareholders to vote their proxies effectively. Through the proxy process, shareholders can decide fundamental corporate questions, and can elect or reject management candidates for their company's Board of Directors.

The power to elect the Board of Directors is a particularly important mechanism for effecting accountability. Corporate directors serve to protect the shareholders, and the corporation itself, from lazy, incompetent or dishonest management. However, directors may do this only if they maintain some degree of independence from management. This independence is protected because directors generally hold their positions at the sufferance of public shareholders. If a company's management controls the corporate voting power, however, that protection is eliminated. Management will be effectively insulated from accountability.

Fidelity is deeply concerned that the disappearance of the "one share, one vote" standard will enable management to remove itself from shareholder control. Without this standard, management could acquire decisive voting power by causing the corporation to place "high vote" shares in friendly hands. Once those shares are issued, management would become self-perpetuating, with no need to account to shareholders.

For the last sixty years, the "one share, one vote" concept has been the rule for the vast majority of major American corporations. This requirement is part of a corporate governance system of checks and balances that, even if imperfect, works reasonably well. The system tends to ensure that management cannot act too foolishly without the risk of being thrown out by shareholders. Shareholder votes are taken only on matters of substantial importance, however, so that corporate management has the opportunity to manage the company on a day-to-day basis.

We are aware, of course, that the Securities and Exchange Commission has proposed to mandate the adoption of a uniform "one share, one vote" rule by all self-regulatory organizations. While an SEC rule of this kind would help ensure the accountability of management to shareholders, the SEC has not yet adopted the proposal. Unless it does in a reasonably timely manner, we believe there is a need for Congress to legislate a "one share, one vote" requirement.

Sincerely,

Robert C Pozen

Robert C. Pozen

bility of financing the growth of the Company by means other than the sale of common stock. It would be grossly unfair to change the rules now, when these alternative methods are no longer available.

4. **Imposition of a universal requirement of full voting rights for all common stock traded on public markets could result in the holders of Class A stock being denied access to those public markets.** Several legislative proposals would prohibit the trading of stock with less than full voting rights in the United States securities markets, but would not prohibit the existence of such stock. Actual voting rights are a matter of state corporate law and could be changed only with the approval of the stockholders now holding control. A corporation such as Media General which now has a dual class capitalization might well elect not to alter that capital structure, with the result that its existing public stockholders would be relegated to selling shares in other markets, such as foreign exchanges.

In making a decision whether to amend a dual capital structure to permit continued trading, directors and controlling stockholders would presumably balance the need to protect the existing control relationship against the desire to maintain the corporation's ready access to the United States common stock equity market.

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